

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-92647; File No. S7-08-21]

**August 12, 2021**

### **Notice of Application for the Amendment of Substituted Compliance Determination Regarding Security-Based Swap Entities Subject to Regulation in the Federal Republic of Germany; Proposed Amendments to Order**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Notice of application for amended substituted compliance determination; proposed amendments to order.

**SUMMARY:** The Securities and Exchange Commission (“Commission”) is soliciting public comment on an application by the Bundesanstalt für Finanzdienstleistungsaufsicht (“BaFin”), pursuant to rule 3a71-6 under the Securities Exchange Act of 1934 (“Exchange Act”), requesting that the Commission amend an existing substituted compliance Order for Germany to extend the Order to nonbank capital and margin requirements (the “Amended Application”). The Commission also is soliciting comment on proposed amendments to the Order and is proposing to amend and restate the Order (the “proposed Amended Order”).

**DATES:** Submit comments on or before **[Insert Date 25 Days after Publication in Federal Register]**.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission’s Internet comment form (<https://www.sec.gov/rules/submitcomments.htm>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-08-21 on the subject line.

Paper comments:

- Send paper comments to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-08-21. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/other.shtml>). Typically, comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NW, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Due to pandemic conditions, however, access to the Commission's public reference room is not permitted at this time. All comments received will be posted without change. Persons submitting comments are cautioned that the Commission does not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make publicly available.

**FOR FURTHER INFORMATION CONTACT:** Carol M. McGee, Assistant Director, at 202-551-5870, Office of Derivatives Policy, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-7010.

**SUPPLEMENTARY INFORMATION:** The Commission is soliciting public comment on the Amended Application. The Commission also is proposing to amend and restate the Order in certain other ways, and is soliciting comment on the proposed Amended Order set forth in Attachment A.

## I. Introduction

Rule 3a71-6 under the Exchange Act provides a framework whereby non-U.S. security-based swap dealers and major security-based swap participants (“SBS Entities”) may satisfy certain requirements under Exchange Act section 15F by complying with comparable regulatory requirements of a foreign jurisdiction. Substituted compliance is intended to promote efficiency and competition within the security-based swap market by helping to address potential duplication and inconsistency between relevant U.S. and foreign requirements, making it possible for SBS Entities to leverage their existing systems and practices to comply with relevant Exchange Act requirements in conjunction with their compliance with relevant foreign requirements.<sup>1</sup>

Pursuant to rule 3a71-6, in December 2020 the Commission issued a substituted compliance Order to provide that German SBS Entities may use substituted compliance with conditions to satisfy certain requirements under the Exchange Act related to risk control, internal supervision and compliance, counterparty protection, and books and records.<sup>2</sup> That Order (and the underlying application from BaFin) did not address substituted compliance for Exchange Act capital and margin requirements applicable to SBS Entities without a prudential regulator.<sup>3</sup>

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<sup>1</sup> Exchange Act Release No. 90765 (Dec. 22, 2020), 85 FR 85686, 85687 (Dec. 29, 2020) (“Order”).

<sup>2</sup> Id. at 85689-97.

<sup>3</sup> Section 15F(e)(1)(B) of the Exchange Act provides that SBS Entities for which there is not a prudential regulator shall meet such minimum capital requirements and minimum initial and variation margin requirements as the Commission shall by rule or regulation prescribe. The term “prudential regulator” is defined in Section 1(a)(39) of the Commodity Exchange Act (7 U.S.C. 1(a)(39)) and that definition is incorporated by reference in Section 3(a)(74) of the Exchange Act. Pursuant to the definition, the Board of Governors of the Federal Reserve System (“Federal Reserve”), the Office of the Comptroller of the Currency (“OCC”), the Federal Deposit Insurance Corporation (“FDIC”), the Farm Credit Administration, or the Federal Housing Finance Agency is the “prudential regulator” of an SBS Entity if the entity is directly supervised by that agency. The Commission adopted Exchange Act rules 18a-1 through 18a-1d (capital) and 18a-3 (margin)

In the Commission’s preliminary view, certain developments warrant modifications to the substituted compliance Order for Germany. First, since finalizing the Order, the Commission has finalized substituted compliance orders for SBS Entities subject to regulation in the French Republic (“France”)<sup>4</sup> and the United Kingdom (“UK”).<sup>5</sup> When finalizing the French and UK Orders, the Commission had the benefit of additional public comment, some of which also referenced the Order.<sup>6</sup> Particularly given substantial similarity of the three regimes, the Commission believes that modifications to the Order may be necessary for consistency. The Commission is therefore proposing to amend the Order to align with the French and UK orders where appropriate.

Moreover, BaFin’s Amended Application requests that the Commission extend the Order to also provide for substituted compliance for the capital requirements of Exchange Act Section

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pursuant to Section 15F(e)(1)(B) of the Exchange Act. See Exchange Act Release No. 86175 (June 21, 2019) 84 FR 43872, 43879 (Aug. 22, 2019) (“Capital and Margin Adopting Release”).

<sup>4</sup> Exchange Act Release No. 92494 (July 23, 2021), 86 FR 41612 (Aug. 2, 2021) (“French Order”). See also Exchange Act No. 90766 (Dec. 22, 2020), 85 FR 85720 (Dec. 29, 2020) (“French Substituted Compliance Notice and Proposed Order”); Exchange Act Release No. 91477 (Apr. 5, 2021), 86 FR 18341 (Apr. 8, 2021) (“Reopening Release”).

<sup>5</sup> Exchange Act Release No. 92529 (July 30, 2021), 86 FR 43318 (August 6, 2021) (“UK Order”). See also Exchange Act Release No. 91476 (Apr. 5, 2021), 86 FR 18378 (Apr. 8, 2021) (“UK Substituted Compliance Notice and Proposed Order”).

<sup>6</sup> See, e.g., Letter from Kyle Brandon, Managing Director, Head of Derivative Policy, SIFMA (Jan. 25, 2021) (“SIFMA Letter I”); Letter from Wim Mijs, Chief Executive Officer, European Banking Federation (Jan. 25, 2021) (“EBF Letter I”) (generally supporting the SIFMA Letter I); Letter from Etienne Barel, Deputy Chief Executive Officer, French Banking Federation (Jan. 25, 2021) (“FBF Letter I”), Letter from Kyle Brandon, Managing Director, Head of Derivative Policy, SIFMA (May 3, 2021) (“SIFMA Letter II”); Letter from Wim Mijs, Chief Executive Officer, European Banking Federation (May 3, 2021) (“EBF Letter II”); Letter from Etienne Barel, Deputy Chief Executive Officer, French Banking Federation (May 3, 2021) (“FBF Letter II”); Letter from Americans for Financial Reform Education Fund (May 3, 2021) (“AFREF Letter”); Letter from Dennis M. Kelleher, President and CEO, Stephen Hall, Legal Director and Securities Specialist, and Jason Grimes, Senior Counsel, Better Markets, Inc. (May 3, 2021) (“Better Markets Letter”). Comments may be found on the Commission’s website at: <https://www.sec.gov/comments/s7-22-20/s72220.htm>.

15F(e) and Exchange Act rules 18a-1 through 18a-1d (collectively, “Exchange Act Rule 18a-1”), the margin requirements Exchange Act Section 15F(e) and Exchange Act rule 18a-3, and related recordkeeping, reporting, notification, and securities count requirements.<sup>7</sup> As discussed in parts IV and VII below, the Commission is proposing to amend the Order to conditionally permit German SBS Entities to comply with these requirements via substituted compliance.<sup>8</sup>

## II. Scope of Substituted Compliance and Additional General Conditions

### A. Scope of Substituted Compliance

For entity-level Exchange Act requirements,<sup>9</sup> a Covered Entity must choose either to apply substituted compliance pursuant to the Order with respect to all security-based swap business subject to the relevant German and EU requirements or to comply directly with the Exchange Act with respect to all such business; a Covered Entity may not choose to apply

<sup>7</sup> Letter from Thorsten Pötzsch, Chief Executive Director of BaFin’s Resolution Sector, BaFin, to Vanessa Countryman, Secretary, Commission, dated August 12, 2021. The Amended Application is available on the Commission’s website at: <https://www.sec.gov/page/exchange-act-substituted-compliance-and-listed-jurisdiction-applications-security-based-swap>.

<sup>8</sup> The Amended Application requests substituted compliance with respect to investment firms and credit institutions that are authorized by BaFin to provide investment services or perform investment activities in Germany and are supervised by the ECB (or have a licensing application pending with the ECB as of the date of this application letter) as a significant institution. See Amended Application at 1. As such, the Commission is proposing to amend the definition of Covered Entity to conform to the request and the information provided. See para. (g)(1)(iii).

<sup>9</sup> The entity-level requirements relate to non-bank capital and margin, books and records (other than those linked to the counterparty protection rules), internal risk management systems, trade acknowledgement and verification, portfolio reconciliation, compression, trading relationship documentation, and internal supervision and chief compliance officer requirements See Capital and Margin Adopting Release, 84 FR at 43879; Exchange Act Release No. 87005 (June 19, 2019) 84 FR 68550, 68596 (Dec. 16, 2019) (“Books and Records Adopting Release”); Exchange Act Release No. 78011 (June 8, 2016) 81 FR 39808, 39827 (June 17, 2016) (“TAV Adopting Release”); Exchange Act Release No. 87782 (Dec. 18, 2019) 85 FR 6359, 6378 (Feb. 4, 2020) (“Risk Mitigation Adopting Release”); Exchange Act Release No. 77617 (Apr. 14, 2016), 81 FR 29960, 30064 (May 13, 2016) (“Business Conduct Adopting Release”). Transaction-level requirements encompass business conduct requirements for the protection of counterparties, and additional provisions for the protection of special entities. See also Business Conduct Adopting Release, 81 FR at 30065.

substituted compliance for some of the business subject to the relevant German or EU requirements and comply directly with the Exchange Act for another part of the business that is subject to the relevant German and EU requirements. Additionally, for entity-level Exchange Act requirements, if the Covered Entity also has security-based swap business that is not subject to the relevant German requirements, the Covered Entity must either comply directly with the Exchange Act for that business or comply with the terms of another applicable substituted compliance order.<sup>10</sup> For transaction-level Exchange Act requirements,<sup>11</sup> a Covered Entity may decide to apply substituted compliance for some of its security-based swap business and to comply directly with the Exchange Act (or comply with another applicable substituted compliance order) for other parts of its security-based swap business.

B. Proposed revision of general condition regarding notice

The Commission also is proposing to modify the Order's general condition requiring that Covered Entities provide the Commission with written notice of their intent to rely on substituted compliance. To promote clarity in the notice regarding the Covered Entity's intended use of substituted compliance, the Commission is proposing to amend the general condition to require that the notice identify each specific substituted compliance determination for which the Covered

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<sup>10</sup> In the context of the EMIR counterparties condition in para. (a)(5) of the proposed Amended Order, a Covered Entity must choose (1) to apply substituted compliance pursuant to the Order—including compliance with para. (a)(5) as applicable—for a particular set of entity-level requirements with respect to all of its business that would be subject to the relevant EMIR-based requirement if the counterparty were the relevant type of counterparty, or (2) to comply directly with the Exchange Act with respect to such business.

<sup>11</sup> Transaction-level requirements are the counterparty protection requirements and the books and records requirements related to those counterparty protection requirements.

Entity intends to apply substituted compliance.<sup>12</sup> The modification would be consistent with the conditions for notification included in the Commission's other substituted compliance orders.<sup>13</sup>

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<sup>12</sup> See para. (a)(9) of the proposed Amended Order. To promote up-to-date notice, the proposal further would require the Covered Entity to amend the notice if it modifies the scope of its reliance on substituted compliance. In addition, the proposal would make a technical modification to the general condition to clarify that the notice must be sent to the Commission in the manner specified on the Commission's website (in lieu of the condition's current reference to an email address specified on that website).

<sup>13</sup> See French Order, 86 FR at 41658; UK Order, 86 FR at 43371. As explained in the French and UK Orders, under the proposed amended notification provision, if a Covered Entity intends to rely on all the substituted compliance determinations in a given paragraph of the Order, it could cite that paragraph in the notice. For example, if the Covered Entity intends to rely on the capital and margin determinations in paragraph (c) of the proposed Amended Order, it would indicate in the notice that it is relying on the determinations in paragraph (c). However, if the Covered Entity intends to rely on the margin determination but not the capital determination, it would need to indicate in the notice that it is relying on paragraph (c)(2) of the proposed Amended Order (the margin determination). In this case, paragraph (c)(1) of the proposed Amended Order (the capital determination) would be excluded from the notice and the Covered Entity would need to comply with the Exchange Act capital requirements. Further, as discussed below in part VII.B.1, the amended recordkeeping and reporting determinations in the proposed Amended Order have been structured to provide Covered Entities with a high level of flexibility in selecting specific requirements within those rules for which they want to rely on substituted compliance. For example, paragraph (f)(1)(i) of the proposed Amended Order sets forth the Commission's substituted compliance preliminary determinations with respect to the requirements of Exchange Act rule 18a-5, 17 CFR 240.18a-5. These preliminary determinations are set forth in paragraphs (f)(1)(i)(A) through (O) of the proposed Amended Order. If a Covered Entity intends to rely on some but not all of the preliminary determinations, it would need to identify in the notice the specific preliminary determinations in this paragraph it intends to rely on (e.g., paragraphs (f)(1)(i)(A), (B), (C), (D), (G), (H), (I), and (O)). For any determinations excluded from the notice, the Covered Entity would need to comply with the Exchange Act rule 18a-5 requirement. Finally, a Covered Entity would be able to apply substituted compliance at the transaction level (rather than the entity level) for certain counterparty protection requirements and the recordkeeping requirements that are linked to them. In this case, the notice would need to indicate the class of transactions (e.g., transactions with UK counterparties) for which the Covered Entity is applying substituted compliance with respect to the Exchange Act counterparty protection requirements and linked recordkeeping requirements. Similarly, as discussed above, a Covered Entity would be able to apply substituted compliance for entity-level Exchange Act requirements to all of its security-based swap business that is eligible for substituted compliance under the proposed Amended Order, and may either comply directly with the Exchange Act or apply substituted compliance under another applicable order for its security-based swap business that is not eligible for substituted compliance under the proposed Amended Order. In this case, the notice would need to indicate the scope of security-based swap business (e.g., security-based swap business carried on from an establishment in the UK) for which the Covered Entity is applying substituted compliance with respect to the relevant Exchange Act entity-level requirements. A Covered Entity would modify its reliance on the positive substituted compliance determinations in the Order, and thereby trigger the requirement to update its notice, if it adds or

C. Additional condition regarding notification requirements related to changes in capital

Consistent with the UK and French Orders, the Commission is proposing to add a general condition that Covered Entities with a prudential regulator relying on substituted compliance pursuant to the proposed Amended Order must apply substituted compliance with respect to the requirements of Exchange Act rule 18a-8(c) and the requirements of Exchange Act rule 18a-8(h) as applied to Exchange Act rule 18a-8(c).<sup>14</sup> In the UK and French Orders, the Commission took a granular approach with respect to substituted compliance determinations regarding the Exchange Act recordkeeping, reporting, and notification requirements. Consequently, a Covered Entity may comply directly with certain of the Exchange Act's recordkeeping, reporting, and notification provisions while applying substituted compliance to others. In taking this granular approach, the Commission conditioned substituted compliance with certain of the discrete recordkeeping, reporting, and notification requirements on the Covered Entity applying substituted compliance for the substantive Exchange Act requirement to which they are linked.<sup>15</sup> Further, the Commission conditioned substituted compliance with respect to the substantive requirement on the Covered Entity applying substituted compliance for the linked recordkeeping, reporting, or notification requirement. These linked conditions are designed to ensure that a Covered Entity consistently applies substituted compliance with respect to the substantive

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subtracts determinations for which it is applying substituted compliance or completely discontinues its reliance on the proposed Amended Order.

<sup>14</sup> See para. (a)(11) of the proposed Amended Order. See also French Order, 86 FR at 41620-22; UK Order, 86 FR at 43330-31.

<sup>15</sup> See French Order, 86 FR at 41621; UK Order, 86 FR at 43330.



Exchange Act requirement and the Exchange Act recordkeeping, reporting, or notification requirement that complements the substantive requirement.

Exchange Act rule 18a-8(c) generally requires every prudentially regulated security-based swap dealer that files a notice of adjustment of its reported capital category with the Federal Reserve, the OCC, or the FDIC to give notice of this fact that same day by transmitting a copy of the notice of adjustment of reported capital category in accordance with Exchange Act rule 18a-8(h).<sup>16</sup> Exchange Act rule 18a-8(h) sets forth the manner in which every notice or report required to be given or transmitted pursuant to Exchange Act rule 18a-8 must be made.<sup>17</sup> While Exchange Act rule 18a-8(c) is not linked to a substantive Exchange Act requirement, it is linked to substantive capital requirements applicable to prudentially regulated SBS Entities in the U.S. (i.e., capital requirements of the Federal Reserve, the OCC, or the FDIC). Therefore, to implement the granular approach adopted in the U.K. and French Orders, the Commission is proposing to add a general condition that Covered Entities with a prudential regulator relying on substituted compliance must apply substituted compliance with respect to the requirements of Exchange Act rule 18a-8(c) and the requirements of Exchange Act rule 18a-8(h) as applied to Exchange Act rule (c).

In its application, BaFin cited several German and EU provisions as providing similar outcomes to the notification requirements of Exchange Act rule 18a-8.<sup>18</sup> This general condition is necessary in order to clarify that a prudentially regulated Covered Entity must provide the

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<sup>16</sup> See 17 CFR 240.18a-8(c).

<sup>17</sup> See 17 CFR 240.18a-8(h).

<sup>18</sup> These German provisions include KWG section 25a(1) sentence 6 no. 3, and FinDAG section 4d, which provide, among other things, processes for employees to report breaches of certain EU regulations, and the establishment of systems by BaFin to accept reports of potential or actual violations of laws, ordinances, general rulings, and regulations and directives of the EU.

Commission with copies of any notifications regarding changes in the Covered Entity's capital situation required by German or EU law. In particular, absent this condition, a prudentially regulated Covered Entity could elect not to apply substituted compliance with respect to Exchange Act rule 18a-8(c). However, because the Covered Entity is not required to provide any notifications to the Federal Reserve, the OCC, or the FDIC, "compliance" with the provisions of Exchange Act rule 18a-8(c) raises a question as to the Covered Entity's obligations under this proposed Amended Order to provide the Commission with notification of changes in capital.

The Commission adopted Exchange Act Rule 18a-8(c) to require SBS Entities with a prudential regulator to give notice to the Commission when filing an adjustment of reported capital category because such notices may indicate that the entity is in or is approaching financial difficulty.<sup>19</sup> The Commission has a regulatory interest in being notified of changes in the capital of a prudentially regulated Covered Entity, as it could signal the firm is in or approaching financial difficulty and presents a risk to U.S. security-based swap markets and participants. For the foregoing reasons, the Commission is conditioning applying substituted compliance pursuant to the proposed Amended Order on the general condition that a prudentially regulated Covered Entity apply substituted compliance with respect to Exchange Act rule 18a-8(c) and the requirements of Exchange Act rule 18a-8(h) as applied to Exchange Act rule 18a-8(c).

D. Proposed amendment to general condition regarding EU cross-border matters

The Commission also is proposing to modify the Order's general condition related to EU cross-border matters. Substituted compliance under the Order in part is predicated on BaFin

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<sup>19</sup> See Exchange Act Release No. 71958 (Sept. 19, 2019), 84 FR 68550, 68589-90 (Dec. 16, 2019) ("Recordkeeping and Reporting Adopting Release") (citing Exchange Act Release No. 71958 (Aug. 17, 2014) 79 FR 25193 (May 2, 2014) at 25249).

being responsible for the supervision and enforcement of Covered Entities in connection with certain MiFID provisions that constitute conditions to individual substituted compliance provisions.<sup>20</sup> That general condition is intended to help ensure that the prerequisites to substituted compliance with respect to supervision and enforcement are satisfied in practice when MiFID allocates responsibility for ensuring compliance to another EU Member State. Because MiFIR is subject to similar allocation provisions,<sup>21</sup> the Commission is proposing to incorporate references to MiFIR requirements into the general condition.<sup>22</sup> This change would be consistent with the French Order.<sup>23</sup>

E. Additional MOU-related general condition

In light of the Amended Application, the Commission also is proposing to add a new general condition that would predicate substituted compliance on the presence of a supervisory and enforcement memorandum of understanding between the Commission and the European Central Bank (“ECB”) and/or BaFin, pertaining to information owned by the ECB.<sup>24</sup> The Commission’s access to this ECB information will assist the Commission’s effective oversight of Covered Entities that use substituted compliance in connection with capital and margin requirements.

### **III. Proposed Changes to Risk Control and Internal Supervision**

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<sup>20</sup> See part III.A, *infra*.

<sup>21</sup> See MiFID art. 35(8) (in part allocating responsibility over MiFIR articles 14 to 26 to competent authorities in member states in which branches are located).

<sup>22</sup> See article (a)(10) of the proposed Amended Order.

<sup>23</sup> See para. (a)(10) of the French Order.

<sup>24</sup> See para. (a)(8) of the proposed Amended Order.

A. Background – Order’s MiFID prerequisites related to trade acknowledgment and verification and trading relationship documentation

Under the Order, substituted compliance for trade acknowledgement and verification and for trading relationship documentation in part requires that relevant SBS Entities (“Covered Entities” as defined in the Order) comply with certain requirements under MiFID (plus the German implementation of MiFID) and with certain requirements under EMIR.<sup>25</sup> Commenters expressed concern that the interplay between those particular MiFID conditions and a separate EU cross-border condition to the Order in practice would preclude the availability of substituted compliance for entities that have branches in other EU Member States.<sup>26</sup>

The commenters requested that the Commission remove those particular MiFID conditions, arguing that compliance with EMIR conditions standing alone still would produce

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<sup>25</sup> See paras. (b)(2) and (b)(5) of the proposed Amended Order.

<sup>26</sup> See SIFMA Letter I at 3-6 (commenting on the French Substituted Compliance Notice and Proposed Order but stating that the concerns applied equally to the German Order). In relevant part, the cross-border condition of paragraph (a)(10) of the proposed Amended Order states that if responsibility for ensuring compliance with any provision of MiFID or MiFIR (or EU or German implementing requirement) that is a condition for substituted compliance is allocated to an authority in a Member State of the EU in whose territory a Covered Entity provides a service, BaFin must be the authority responsible for supervision and enforcement of that provision. In practice (pursuant to MiFID article 35), this allocation of oversight applies to requirements pursuant to MiFID article 25 (“assessment of suitability and appropriateness and reporting to clients”) as well as certain other MiFID provisions not relevant here. In the commenter’s view, application of those MiFID article 25 conditions in connection with trade acknowledgment and verification requirements and trading relationship documentation requirements would “in practice lead to an untenable patchwork of substituted compliance.” See SIFMA Letter I at 3. The commenter further states that SBS Entities “operating branches throughout the EU” would not be able to avail themselves of substituted compliance in connection with these requirements “unless authorities or regulated SBS Entities in every or nearly every one of the 27 EU Member States submit their own substituted compliance applications covering local branches of SBS Entities, and the Commission reviews and responds to those applications and enters into memoranda of understanding . . . with authorities in each of these Member States.” That problem does not arise in connection with requirements under EMIR, which does not allocate oversight of a German entity’s compliance to authorities in other EU Member States. That problem also does not arise in connection with other requirements under MiFID (e.g., MiFID art. 16 organizational provisions) that are not subject to the same allocation of oversight.

regulatory outcomes comparable to those of the trade acknowledgment and verification requirement and the trading relationship documentation requirement under the Exchange Act.<sup>27</sup>

After careful consideration, the Commission is proposing to amend the Order to address those concerns and for consistency with the French Order. The Order's EU cross-border condition provides an important safeguard to help ensure that firms that avail themselves of substituted compliance are subject to appropriate regulatory supervision and enforcement. At the same time, the Commission recognizes the significance of commenter concerns that the interplay between the EU cross-border condition and the MiFID conditions associated with trade acknowledgment and verification and with trading relationship documentation could have the effect of unnecessarily interfering with the use of substituted compliance when other provisions standing alone are sufficient for the Commission to make a positive substituted compliance determination.<sup>28</sup> As discussed below, the Commission is proposing to revise the Order's conditions related to trade acknowledgment and verification and to trading relationship documentation, by removing MiFID-related conditions and instead relying solely on EMIR conditions to establish comparability for those requirements.

B. Proposed addition of EMIR-related general conditions

The proposed amendments addressed below would remove MiFID conditions and rely solely on EMIR conditions to establish comparability in connection with trade acknowledgment

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<sup>27</sup> See SIFMA letter I at 5-6.

<sup>28</sup> SBS Entities subject to regulation in France are subject to the condition, and the proposed change would be consistent with the French Order. See para. (a)(10) of the French Order. The Commission addressed certain of the other issues raised by commenters when extending the comment period for the French Substituted Compliance Notice and Proposed Order. See Reopening Release, 86 FR 18341 (discussing commenter concerns regarding the scope of reliance on substituted compliance and the EU cross-border condition).

and verification and trading relationship documentation. This heightened reliance on EMIR highlights the need for safeguards to help ensure that there will be no opportunity for gaps that may prevent the EMIR provisions in practice from producing outcomes consistent with those of the Exchange Act rules. The Commission accordingly is proposing to add two EMIR-related general conditions to the Order to help preclude such gaps.<sup>29</sup>

The first condition provides that the Covered Entity must comply with the applicable condition of the proposed Amended Order as if the counterparty were the type of counterparty that would trigger the application of the relevant EMIR-based requirements. If the Covered Entity reasonably determines that its counterparty would be a financial counterparty<sup>30</sup> if not for the counterparty's location and/or lack of regulatory authorization in the EU, the condition further requires the Covered Entity to treat the counterparty as if the counterparty were a financial counterparty, rather than as another type of counterparty to which the relevant EMIR-based requirements may apply.<sup>31</sup> By requiring a Covered Entity to treat its counterparty as a type of counterparty that would trigger the application of the relevant EMIR-based requirements, the condition will require the Covered Entity to perform the relevant obligations pursuant to

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<sup>29</sup> The proposed addition of two new EMIR-related general conditions as paragraphs (a)(5) and (a)(6) of the proposed Amended Order would necessitate renumbering of certain of the extant general conditions, and also suggests the need to clarify the captions for certain of the other proposed general conditions (e.g., recaptioning proposed general conditions (a)(1) through (a)(3) of the proposed Amended Order to specifically refer to MiFID, and recaptioning of proposed general condition (a)(4) to specifically refer to CRD/CRR).

<sup>30</sup> EMIR article 2(8) defines “financial counterparty” to encompass investment firms, credit institutions, insurers and certain other types of businesses that have been authorized in accordance with EU law. Under EMIR, the distinction between financial counterparties and other types of counterparties such as non-financial counterparties is manifested, *inter alia*, in connection with confirmation timing standards. See EMIR RTS article 12.

<sup>31</sup> See para. (a)(5) of the proposed Amended Order.

those EMIR-based requirements and thus to act in a way that is comparable to Exchange Act requirements.<sup>32</sup>

In addition, the Commission is proposing to revise the Order to account for the fact that the relevant trade acknowledgement and verification and trading relationship documentation rules under the Exchange Act do not apply to security-based swaps cleared by a clearing agency registered with the Commission (or exempt from registration), while the analogous EMIR provisions exclude instruments that are cleared by a central counterparty that has been authorized or recognized to clear derivatives contracts in the EU. In particular – to help ensure that substituted compliance is available in connection with an instrument that has been cleared at an EU-authorized or EU-recognized central counterparty (and hence is not within the Exchange Act rule’s exclusion but also is not subject to relevant EMIR requirements) – the Commission is proposing a new general condition that, for each part of the Order that requires compliance with

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<sup>32</sup> In other words, the Covered Entity would be subject to the relevant requirements under EMIR even if the counterparty is not an “undertaking” (such as by virtue of being a natural person), or is not established in the EU (by virtue of being a U.S. person or otherwise being established in some non-EU jurisdiction). The issue of whether the Covered Entity must treat the counterparty as a “financial counterparty” or “non-financial counterparty” would turn on whether the counterparty’s business would require that it be registered pursuant to the categories identified in the EMIR article 2(8) “financial counterparty” definition (e.g., an authorized investment firm, credit institution, insurance undertaking) were the counterparty subject to the applicable authorization requirements. This approach generally appears to be consistent with European guidance. See European Securities and Markets Authority, “Questions and Answers: Implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR)” ([https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52\\_qa\\_on\\_emir\\_implementation.pdf](https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52_qa_on_emir_implementation.pdf)) answer 5(a) (stating that compliance with the EMIR confirmation requirement necessitates that the counterparties must reach a legally binding agreement to all terms of the OTC derivative contract, and that the EMIR RTS “implies” that both parties must comply and agree in advance to a specific process to do so); answer 12(b) (stating that where an EU counterparty transacts with a third country entity, the EU counterparty generally must ensure that the EMIR requirements for portfolio reconciliation, dispute resolution, timely confirmation and portfolio compression are met for the relevant portfolio and/or transactions even though the third country entity would not itself be subject to EMIR; this is subject to special processes when the European Commission has declared the third country requirements to be comparable to EU requirements).

EMIR-related requirements, either: (i) the relevant security-based swap is an “OTC derivative” or “OTC derivative contract,” as defined in EMIR article 2(7), that has not been cleared by a central counterparty and otherwise is subject to the provisions of EMIR article 11, EMIR RTS articles 11 through 15, and EMIR Margin RTS article 2; or (ii) the relevant security-based swap has been cleared by a central counterparty that has been authorized or recognized to clear derivatives contracts by a relevant authority in the EU.<sup>33</sup>

C. Proposed revisions to conditions related to trade acknowledgment and verification, and trading relationship documentation

Consistent with the French Order<sup>34</sup> the Commission is proposing to modify the Order to remove the existing MiFID conditions to substituted compliance for trade acknowledgment and verification. Substituted compliance instead would be conditioned solely on compliance with the confirmation provisions of EMIR article 11(1)(a) and EMIR RTS article 12.<sup>35</sup> Those EMIR provisions promote comparable risk control goals as the Exchange Act rule by providing for definitive written records of transactions. While the Commission recognizes that MiFID confirmation requirements also help to promote that goal, the Commission preliminarily believes that the EMIR provisions alone are sufficient for regulatory comparability, and recognizes that in practice the interplay between the EU cross-border condition and MiFID confirmation requirements may unnecessarily limit the use of substituted compliance and its associated efficiency benefits.

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<sup>33</sup> See para. (a)(6) of the proposed Amended Order. Prong (i) to this proposed condition would be satisfied by uncleared instruments that fall within the ambit of the EMIR requirements at issue. The alternative prong (ii) would be satisfied when instruments fall outside the ambit of those EMIR requirements by virtue of being cleared in the EU, akin to the Exchange Act rules’ exclusion for security-based swaps cleared by clearing agencies registered with the Commission.

<sup>34</sup> See para. (b)(2) of the French Order.

<sup>35</sup> See para. (b)(2) of the proposed Amended Order.



The Commission similarly is proposing to modify the Order to remove the existing MiFID conditions to substituted compliance for trading relationship documentation, and also to add the above EMIR confirmation provisions (reflecting that the Exchange Act trading relationship documentation rule requires that the necessary documentation include trade acknowledgments and verifications<sup>36</sup>). Together with EMIR Margin RTS article 2 provisions that address risk management procedures related to the exchange of collateral, including procedures related to the terms of all necessary agreements to be entered into by counterparties (e.g., payment obligations, netting conditions, events of default, calculation methods, transfers of rights and obligations upon termination, and governing law), the EMIR conditions promote comparable risk mitigation purposes as the trading relationship documentation rule under the Exchange Act by promoting certainty regarding the relevant framework governing the counterparties. Here too, while the Commission recognizes that MiFID documentation requirements also promote that goal, the Commission preliminarily believes the EMIR provisions alone are sufficient for regulatory comparability, and recognizes that in practice the interplay between the EU cross-border condition and MiFID documentation provisions may limit the use of substituted compliance and its associated regulatory benefits.<sup>37</sup>

D. Proposed revisions to Internal Risk Management and Internal Supervision

The Commission is also proposing to incorporate – as part of the relevant conditions in paragraph (b)(1) of the proposed Amended Order relating to internal risk management – MiFID articles 16 and 23 and the related implementing provisions, MiFID Org Reg articles 25 through

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<sup>36</sup> See Exchange Act rule 15Fi-5(b)(2).

<sup>37</sup> These proposed changes are consistent with the French Order. See paras. (a)(5) and (a)(6) of the French Order.

37, 72 through 76 and Annex IV, as well as CRD articles 88(1), 91(1)-(2) and (7)-(9) and the related implementing provisions.<sup>38</sup> These provisions address additional aspects of a Covered Entity's management of the risks posed by internal governance and organization, business operations, conflicts of interest with and between clients, and senior staff remuneration policies and were part of the Commission's comparability determination for entities subject to regulation in France. The Commission is also incorporating CRR articles 286-88 and 293 and EMIR Margin RTS article 2 to the conditions of paragraph (d)(3) of the proposed Amended Order relating to internal supervision.<sup>39</sup> These provisions relate to counterparty credit risk and risk management generally and collateral-related risk management procedures and were also part of the Commission's comparability analysis in the French Order.<sup>40</sup> Also consistent with the French Order, the Commission is proposing to delete CRD article 93 and the related implementing provisions from both paragraph (d)(1) and (d)(3), as those provisions relate to remuneration policies for institutions that benefit from exceptional (German and EU) government intervention.<sup>41</sup>

#### **IV. Proposed Substituted Compliance in connection with Capital and Margin**

##### **A. BaFin's request and associated analytic considerations**

The Amended Application in part requests substituted compliance in connection with requirements under the Exchange Act relating to:

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<sup>38</sup> See para. (b)(1) of the proposed Amended Order.

<sup>39</sup> See para. (d)(3) of the proposed Amended Order.

<sup>40</sup> See paras. (b)(1) and (d)(3) of the French Order.

<sup>41</sup> See paras. (b)(1) and (d)(3) of the proposed Amended Order.

- Capital – Capital requirements pursuant to Exchange Act section 15F(e) and Exchange Act rule 18a-1 and 18a-1a through 18a-1d applicable to certain SBS Entities.<sup>42</sup> Exchange Act rule 18a-1 helps to ensure the SBS Entity maintains at all times sufficient liquid assets to promptly satisfy its liabilities, and to provide a cushion of liquid assets in excess of liabilities to cover potential market, credit, and other risks.<sup>43</sup> The rule’s net liquid assets test standard protects customers and counterparties and mitigates the consequences of an SBS Entity’s failure by promoting the ability of the firm to absorb financial shocks and, if necessary, to self-liquidate in an orderly manner.<sup>44</sup> As part of the capital requirements, security-based swap dealers without a prudential regulator also must comply with the internal risk management control requirements of Exchange Act Rule 15c3-4 with respect to certain activities.<sup>45</sup>

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<sup>42</sup> Exchange Act rule 18a-1 applies to security-based swap dealers that: (1) do not have a prudential regulator; and (2) are either (a) not dually registered with the Commission as a broker-dealer or (b) are dually registered with the Commission as a special purpose broker-dealer known as an OTC derivatives dealer. Security-based swap dealers that are dually registered with the Commission as a full-service broker-dealer are subject to the capital requirements of Exchange Act rule 15c3-1 (17 CFR 240.15c3-1) for which substituted compliance is not available. *See* 17 CFR 240.3a71-6(d)(4)(i) (making substituted compliance available only with respect to the capital requirements of Exchange Act section 15F(e) and Exchange Act rule 18a-1).

<sup>43</sup> See Capital and Margin Adopting Release, 84 FR at 43947. The Amended Application discusses EU and German requirements that address firms’ capital requirements. See Amended Application Annex A category 3 (Side Letter Addressing Capital Requirements). See also Amended Application Annex A category 4 (Internal Risk Management Requirements) (generally discussing internal risk management requirements).

<sup>44</sup> See Capital and Margin Adopting Release, 84 FR at 43879-83. The capital standard of Exchange Act rule 18a-1 is based on the net liquid assets test of Exchange Act rule 15c3-1 applicable to broker-dealers. Id. The net liquid assets test seeks to promote liquidity by requiring that a firm maintain sufficient liquid assets to meet all liabilities, including obligations to customers, counterparties, and other creditors, and, in the event a firm fails financially, to have adequate additional resources to wind-down its business in an orderly manner without the need for a formal proceeding. See id. at 43879. See Amended Application Annex A category 3 (Side Letter Addressing Capital Requirements).

<sup>45</sup> See 17 CFR 240.15c3-4 and 18a-1(f).

- Margin – Margin requirements pursuant to Exchange Act section 15F(e) and Exchange Act rule 18a-3 for non-prudentially regulated SBS Entities.<sup>46</sup> The margin requirements are designed to protect SBS Entities from the consequences of a counterparty’s default.<sup>47</sup>

Taken as a whole, these capital and margin requirements help to promote market stability by mandating that SBS Entities follow practices to manage the market, credit, liquidity, solvency, counterparty, and operational risks associated with their security-based swap businesses. The Commission’s comparability assessment accordingly focuses on whether the analogous foreign requirements – taken as a whole – produce comparable outcomes with regard to providing that Covered Entities follow capital and margin requirements that address the risks associated with their security-based swap businesses.

B. Capital - preliminary views and proposed Amended Order

In the Commission’s preliminary view, based on the Amended Application and the Commission’s review of applicable provisions, additional conditions on applying substituted compliance with respect to the Exchange Act capital requirements are necessary in order to produce comparable regulatory outcomes. Consequently, substituted compliance with respect to the capital requirements of Exchange Act rule 18a-1 would be conditioned on Covered Entities

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<sup>46</sup> 17 CFR 240.18a-3.

<sup>47</sup> See Capital and Margin Adopting Release, 84 FR at 43947, 43949 (“Obtaining collateral is one of the ways OTC derivatives dealers manage their credit risk exposure to OTC derivatives counterparties. Prior to the financial crisis, in certain circumstances, counterparties were able to enter into OTC derivatives transactions without having to deliver collateral. When ‘trigger events’ occurred during the financial crisis, those counterparties faced significant liquidity strains when they were required to deliver collateral”). The Amended Application discusses EU and German requirements that address firms’ margin requirements. See Amended Application Annex A category 4 (Margin Requirements for Nonbank Firms).

being subject to and complying with relevant EU and German capital requirements.<sup>48</sup> However, the proposed Amended Order would include the additional conditions discussed below that, in the aggregate, would be designed to establish a framework that produces outcomes comparable to those associated with the capital requirements of Exchange Act rule 18a-1.

The first additional capital condition would require that the Covered Entity apply substituted compliance with respect to Exchange Act rules 18a-5(a)(9) (a record making requirement), 18a-6(b)(1)(x) (a record preservation requirement), and 18a-8(a)(1)(i), (a)(1)(ii), (b)(1), (b)(2), and (b)(4) (notification requirements relating to capital).<sup>49</sup> These recordkeeping and notification requirements are directly linked to the capital requirements of Exchange Act rule 18a-1. As discussed below in part VII.B.1 of this release, the proposed Amended Order conditions substituted compliance with respect to these recordkeeping and notification requirements on the Covered Entity applying substituted compliance with respect to Exchange Act rule 18a-1.<sup>50</sup> This proposed capital condition would do the reverse: condition substituted compliance with respect to Exchange Act rule 18a-1 on the Covered Entity applying substituted compliance for these linked recordkeeping and notification requirements. This additional capital condition is designed to provide clarity as to the Covered Entity's obligations under these

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<sup>48</sup> In connection with capital requirements, Covered Entities must comply with: CRR, Part One (General Provisions) Article 6(1), Part Two (Own Funds), Part Three (Capital Requirements), Part Four (Large Exposures), Part Five (Exposures to Transferred Credit Risk), Part Six (Liquidity), and Part Seven (Leverage); MiFID Org Reg article 23; BRRD articles 45(6) and 81(1); CRD articles 73, 79, 86, 129, 129(1), 130, 130(1), 130(5), 131, 133, 133(1), 133(4), 141, and 142(1) and (2); EMIR Margin RTS articles 2, 3(b), 7, and 19(1)(d) and (e), (3) and (8); KWG sections 10b-10h, 10i(2)-(9), 25a(1) sentence 3 no. 2 and no. 3b), 33(1) sentence 1c), ; SAG section 49(2), 49d, 62(1), 138(1); and SolvV section 37. See para. (c)(1)(i) of the proposed Amended Order.

<sup>49</sup> See para. (c)(1)(ii) of the proposed Amended Order. This additional condition is included in the French and UK Orders. See French Order, 86 FR at 41659; UK Order, 86 FR at 43372.

<sup>50</sup> See paras. (f)(1)(i)(J), (f)(2)(i)(J), and (f)(4)(i)(A) of the proposed Amended Order.

recordkeeping and notification requirements when applying substituted compliance with respect to Exchange Act rule 18a-1 pursuant the proposed Amended Order.

The second additional capital condition would be designed to ensure comparable regulatory outcomes between the standard of Exchange Act rule 18a-1 and the capital standard of the relevant EU and German laws, which is based on the international capital standard for banks (the “Basel capital standard”).<sup>51</sup> In particular, the capital standard of Exchange Act rule 18a-1 is the net liquid assets test. This is the same capital standard that applies to broker-dealers under Exchange Act rule 15c3-1.<sup>52</sup> The net liquid assets test is designed to promote liquidity.<sup>53</sup> In particular, Exchange Act rule 18a-1 allows an SBS Entity to engage in activities that are part of conducting a securities business (e.g., taking securities into inventory) but in a manner that places the firm in the position of holding at all times more than one dollar of highly liquid assets for each dollar of unsubordinated liabilities (e.g., money owed to customers, counterparties, and creditors).<sup>54</sup> For example, Exchange Act rule 18a-1 allows securities positions to count as

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<sup>51</sup> See note 48, *supra* (citing EU and German capital requirements under the CRR). See also Basel Committee on Banking Supervision (“BCBS”), The Basel Framework, available at: [https://www.bis.org/basel\\_framework/](https://www.bis.org/basel_framework/).

<sup>52</sup> See, e.g., Capital and Margin Adopting Release, 84 FR at 43881 (“The Commission believes that the broker-dealer capital standard is the most appropriate alternative for nonbank SBSs, given the nature of their business activities and the Commission’s experience administering the standard with respect to broker-dealers. The objective of the broker-dealer capital standard is to protect customers and counterparties and to mitigate the consequences of a firm’s failure by promoting the ability of these entities to absorb financial shocks and, if necessary, to self-liquidate in an orderly manner.”).

<sup>53</sup> See *id.* (“Consequently, in the Commission’s judgment, the broker-dealer capital standard is the appropriate standard for nonbank SBSs because it is designed to promote a firm’s liquidity and self-sufficiency (in other words, to account for the lack of inexpensive funding sources that are available to banks, such as deposits and central bank support).”).

<sup>54</sup> See, e.g., Exchange Act Release No. 8024 (Jan. 18, 1967), 32 FR 856 (Jan. 25, 1967) (“Rule 15c3-1 (17 CFR 240.15c3-1) was adopted to provide safeguards for public investors by setting standards of financial responsibility to be met by brokers and dealers. The basic concept of the rule is liquidity; its object being to require a broker-dealer to have at all times sufficient liquid assets to cover his current indebtedness.”) (footnotes omitted); Exchange Act Release No. 10209

allowable net capital, subject to standardized or internal model-based haircuts. The rule, however, does not permit most unsecured receivables to count as allowable net capital. This aspect of the rule severely limits the ability of SBS Entities to engage in activities, such as uncollateralized lending, that generate unsecured receivables. The rule also does not permit fixed assets or other illiquid assets to count as allowable net capital, which creates disincentives for SBS Entities to own real estate and other fixed assets that cannot be readily converted into cash. For these reasons, Exchange Act rule 18a-1 incentivizes SBS Entities to confine their business activities and devote capital to security-based swap activities.

The net liquid assets test is imposed through how an SBS Entity is required to compute net capital pursuant to Exchange Act rule 18a-1. The first step is to compute the SBS Entity's net worth under generally accepted accounting principles ("GAAP"). Next, the SBS Entity must make certain adjustments to its net worth to calculate net capital, such as deducting illiquid assets and taking other capital charges and adding qualifying subordinated loans.<sup>55</sup> The amount remaining after these deductions is defined as "tentative net capital." Exchange Act rule 18a-1

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(June 8, 1973), 38 FR 16774 (June 26, 1973) (Commission release of a letter from the Division of Market Regulation) ("The purpose of the net capital rule is to require a broker or dealer to have at all times sufficient liquid assets to cover its current indebtedness. The need for liquidity has long been recognized as vital to the public interest and for the protection of investors and is predicated on the belief that accounts are not opened and maintained with broker-dealers in anticipation of relying upon suit, judgment and execution to collect claims but rather on a reasonable demand one can liquidate his cash or securities positions."); Exchange Act Release No. 15426 (Dec. 21, 1978), 44 FR 1754 (Jan. 8, 1979) ("The rule requires brokers or dealers to have sufficient cash or liquid assets to protect the cash or securities positions carried in their customers' accounts. The thrust of the rule is to insure that a broker or dealer has sufficient liquid assets to cover current indebtedness."); Exchange Act Release No. 26402 (Dec. 28, 1988), 54 FR 315 (Jan. 5, 1989) ("The rule's design is that broker-dealers maintain liquid assets in sufficient amounts to enable them to satisfy promptly their liabilities. The rule accomplishes this by requiring broker-dealers to maintain liquid assets in excess of their liabilities to protect against potential market and credit risks.") (footnote omitted).

<sup>55</sup> See 17 CFR 240.15c3-1(c)(2).

prescribes a minimum tentative net capital requirement of \$100 million for SBS Entities approved to use models to calculate net capital. An SBS Entity that is meeting its minimum tentative net capital requirement will be in the position where each dollar of unsubordinated liabilities is matched by more than a dollar of highly liquid assets.<sup>56</sup> The final step in computing net capital is to take prescribed percentage deductions (standardized haircuts) or model-based deductions from the mark-to-market value of the SBS Entity's proprietary positions (e.g., securities, money market instruments, and commodities) that are included in its tentative net capital. The amount remaining is the firm's net capital, which must exceed the greater of \$20 million or a ratio amount.

In comparison, the Basel capital standard counts as capital assets that Exchange Act rule 18a-1 would exclude (e.g., loans and most other types of uncollateralized receivables, furniture and fixtures, real estate). The Basel capital standard accommodates the business of banking: making loans (including extending unsecured credit) and taking deposits. While the Covered Entities that would apply substituted compliance with respect to Exchange Act rule 18a-1 will not be banks, the Basel capital standard allows them to count illiquid assets such as real estate

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<sup>56</sup> The highly liquid assets under Exchange Act Rule 18a-1 are otherwise known as "allowable assets" because they are not deducted when computing net capital. See Books and Records Adopting Release, 84 FR at 68673-74, 68677-80 (the sections of the amended Part II of the FOCUS Report setting forth the assets side of the balance sheet and the net capital computation). Illiquid assets otherwise known as "non-allowable assets" are deducted when computing net capital. *Id.* Allowable assets include cash, certain unsecured receivables from broker-dealers and clearing organizations, reverse repurchase agreements, securities borrowed, fully secured customer margin loans, and proprietary securities, commodities, and swaps positions. *Id.* The term "high quality liquid assets" or "HQLA" are defined under the Basel capital standard's liquidity coverage ratio ("LCR") and generally consist of cash and specific classes of liquid securities. See BCBS, LCR30 – High-quality liquid assets (under the Basel capital standards), available at: [https://www.bis.org/basel\\_framework/chapter/LCR/30.htm?](https://www.bis.org/basel_framework/chapter/LCR/30.htm?). Generally, cash and securities that qualify as HQLA under the LCR would be allowable assets under Exchange Act rule 18a-1.



and fixtures as capital. It also allows them to treat unsecured receivables related to activities beyond dealing in security-based swaps as capital notwithstanding the illiquidity of these assets.

Further, one critical example of the difference between the requirements of Exchange Act rule 18a-1 and the Basel capital standard relates to the treatment of initial margin with respect to security-based swaps and swaps. Under the EU margin requirements, Covered Entities will be required to post initial margin to counterparties unless an exception applies.<sup>57</sup> Under Exchange Act rule 18a-1, an SBS Entity cannot count as capital the amount of initial margin posted to a counterparty unless it enters into a special loan agreement with an affiliate.<sup>58</sup> The special loan agreement requires the affiliate to fund the initial margin amount and the agreement must be structured so that the affiliate – rather than the SBS Entity – bears the risk that the counterparty may default on the obligation to return the initial margin. The reason for this restrictive approach to initial margin posted away is that it “would not be available [to the SBS Entity] for other purposes, and, therefore, the firm’s liquidity would be reduced.”<sup>59</sup> Under the Basel capital standard, a Covered Entity can count initial margin posted away as capital without the need to enter into a special loan arrangement with an affiliate. Consequently, because of the ability to include illiquid assets and margin posted away as capital, Covered Entities subject to the Basel capital standard may have less balance sheet liquidity than SBS Entities subject to Exchange Act rule 18a-1.

In summary, there are key differences between the net liquid assets test of Exchange Act rule 18a-1 and the Basel capital standard applicable to Covered Entities. Those differences in

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<sup>57</sup> Exchange Act rule 18a-3 does not require SBS Entities to post initial margin (though it does not prohibit the practice).

<sup>58</sup> See Capital and Margin Adopting Release, 84 FR at 43887-88.

<sup>59</sup> See id. at 43887.

terms of the types of assets that count as regulatory capital and how regulatory capital is calculated lead to different regulatory outcomes. In particular, the net liquid assets test produces a regulatory outcome in which the SBS Entity has more than one dollar of highly liquid assets for each dollar of unsubordinated liabilities.<sup>60</sup> The Basel capital standard — while having measures designed to promote liquidity — does not produce this regulatory outcome.<sup>61</sup> Therefore, the Commission preliminarily believes that an additional capital condition is needed to bridge the gap between these two capital standards and thereby achieve more comparable regulatory outcomes in terms of promoting liquid balance sheets for SBS Entities and Covered Entities.

However, in seeking to bridge this regulatory gap, the additional condition should take into account that Covered Entities are or will be subject to EU and German laws and measures designed to promote liquidity. In particular, Covered Entities are or will be subject to: (1) requirements to hold an amount of HQLA to meet expected payment obligations under stressed conditions for thirty days (the “LCR requirement”);<sup>62</sup> (2) requirements to hold a diversity of stable funding instruments sufficient to meet long-term obligations under both normal and stressed conditions (the “NSFR requirements”);<sup>63</sup> (3) requirements to perform liquidity stress

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<sup>60</sup> As discussed above, highly liquid assets under Exchange Act rule 18a-1 are also known as “allowable assets” and generally are consistent with the LCR’s HQLA.

<sup>61</sup> The Basel capital standard does not preclude a firm from having more than a dollar of highly liquid assets for each dollar of unsubordinated liabilities. Thus, a firm operating pursuant to the standard may structure its assets and liabilities in a manner that achieves this result. However, the standard does not mandate this result. Rather, it would accommodate a firm that seeks to maintain this level of liquidity on its own accord.

<sup>62</sup> See CRR, Article 412(1).

<sup>63</sup> See CRR, Articles 413, 428a and 428az.

tests and manage liquidity risk (the “internal liquidity assessment requirements”);<sup>64</sup> and (4) regular reviews of a Covered Entity’s liquidity risk management processes (the “liquidity review process”).<sup>65</sup> These EU and German laws and measures will require Covered Entities to hold significant levels of liquid assets. However, the laws and measures on their own, do not impose a net liquid assets test. Therefore, the Commission preliminarily believes that an additional condition is necessary to supplement these requirements.

The Commission has taken into account the EU and German liquidity laws and measures discussed above in making a substituted compliance determination with respect to Exchange Act rule 18a-1, and in tailoring additional capital conditions designed to achieve comparable regulatory outcomes. The LCR, NSFR, and internal liquidity assessment requirements collectively will require Covered Entities to maintain pools of unencumbered HQLA to cover potential cash outflows during a 30-day stress period, to fund long-term obligations with stable funding instruments, and to manage liquidity risk. These requirements — coupled with supervisory reviews of the liquidity risk management practices of Covered Entities — will require Covered Entities to hold significant levels of liquid assets. These requirements and measures in combination with the other capital requirements applicable to Covered Entities provide a starting foundation for making a positive substituted compliance determination with respect to the capital requirements of Exchange Act section 15F(e) and Exchange Act rule 18a-1. However, the Commission preliminarily believes that more is needed to achieve a comparable regulatory outcome to the net liquid assets test of Exchange Act rule 18a-1.

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<sup>64</sup> See KWG, Article 25a(1), sentence 3 no. 3b).

<sup>65</sup> See KWG, Article 6b(2) no.7.

For these reasons, the proposed Amended Order includes an additional capital condition that would impose a simplified net liquid assets test.<sup>66</sup> This simplified test would require the Covered Entity to hold more than one dollar of liquid assets for each dollar of liabilities. The simplified net liquid assets test — when coupled with the CRR capital requirements,<sup>67</sup> LCR requirements, NSFR requirements, internal liquidity assessment requirements, and liquidity review process — is designed to produce a regulatory outcome that is comparable to the net liquid assets test of Exchange Act rule 18a-1 (*i.e.*, sufficient liquidity to cover liabilities and to promote the maintenance of highly liquid balance sheets).

More specifically, substituted compliance with respect to Exchange Act rule 18a-1 would be subject to the condition that a Covered Entity: (1) maintains liquid assets (as defined in the proposed condition) that have an aggregate market value that exceeds the amount of the Covered Entity's total liabilities by at least \$100 million before applying the deduction specified in the proposed condition, and by at least \$20 million after applying the deduction specified in the proposed condition; (2) makes and preserves for three years a quarterly record that: (a) identifies and values the liquid assets maintained as defined in the proposed condition, (b) compares the amount of the aggregate value the liquid assets maintained pursuant to the proposed condition to the amount of the Covered Entity's total liabilities and shows the amount of the difference between the two amounts ("the excess liquid assets amount"), and (c) shows the amount of the deduction specified in the proposed condition and the amount that deduction reduces the excess liquid assets amount; (3) notifies the Commission in writing within 24 hours in the manner

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<sup>66</sup> See para. (c)(1)(iii) of the proposed Amended Order. This additional condition is included in the French and UK Orders. See French Order, 86 FR at 41659; UK Order, 86 FR at 43372.

<sup>66</sup> See paras. (f)(1)(i)(J), (f)(2)(i)(J), and (f)(4)(i)(A) of the proposed Amended Order.

<sup>67</sup> See, *e.g.*, CRR, Part 1 (Own Funds, including Tier 1 capital) and Part 2 (Capital Requirements).

specified on the Commission’s website if the Covered Entity fails to meet the requirements of the proposed condition and includes in the notice the contact information of an individual who can provide further information about the failure to meet the requirements; and (4) includes its most recent statement of financial condition filed with its local supervisor (whether audited or unaudited) with its initial written notice to the Commission of its intent to rely on substituted compliance.<sup>68</sup>

Under the first prong of this additional capital condition, the Covered Entity would be required to maintain liquid assets (as defined in the proposed capital condition) that have an aggregate market value that exceeds the amount of the Covered Entity’s total liabilities by at least: (1) \$100 million before applying a deduction (as specified in the proposed capital condition); and (2) \$20 million after applying the deduction.<sup>69</sup> The first prong is designed to be consistent with the \$100 million tentative net capital requirement of Exchange Act rule 18a-1 applicable to SBS Entities approved to use models. As discussed above, Exchange Act rule 18a-1 requires SBS Entities that have been approved to use models to maintain at least *\$100 million* in tentative net capital. And, tentative net capital is the amount that an SBS Entity’s liquid assets exceed its total unsubordinated liabilities *before applying haircuts*. The first prong would require the Covered Entity to subtract total liabilities from total liquid assets. The amount remaining will need to equal or exceed \$100 million. The first prong also is designed to be consistent with the \$20 million fixed-dollar minimum net capital requirement of Exchange Act rule 18a-1. As discussed above, net capital is calculated by *applying haircuts* (deductions) to

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<sup>68</sup> See para. (c)(1)(iii) of the proposed Amended Order. This proposed additional condition is included in the French and UK Orders. See French Order, 86 FR at 41659; UK Order, 86 FR at 43372.

<sup>69</sup> See para. (c)(1)(iii)(A)(I) of the proposed Amended Order. The definition of “liquid assets” and the method of calculating the deductions are discussed below.

tentative net capital and the fixed-dollar minimum requires that net capital must equal or exceed \$20 million. The first prong would require the Covered Entity to subtract total liabilities from total liquid assets and then apply the deduction to the difference. The amount remaining after the deduction would need to equal or exceed \$20 million.

For the purposes of the first prong, “liquid assets” would be defined as: (1) cash and cash equivalents; (2) collateralized agreements; (3) customer and other trading related receivables; (4) trading and financial assets; and (5) initial margin posted by the Covered Entity to a counterparty or third-party (subject to certain conditions discussed below).<sup>70</sup> These categories of liquid assets are designed to align with assets that are considered allowable assets for purposes of calculating net capital under Exchange Act rule 18a-1.<sup>71</sup> Further, the first four categories of liquid assets also are designed to align with how Covered Entities categorize liquid assets on their financial statements.

The first category of liquid assets would be cash and cash equivalents.<sup>72</sup> These assets would consist of cash and demand deposits at banks (net of overdrafts) and highly liquid investments with original maturities of three months or less that are readily convertible into known amounts of cash and subject to insignificant risk of change in value.<sup>73</sup> The second

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<sup>70</sup> See para. (c)(1)(iii)(B) of the proposed Amended Order.

<sup>71</sup> See supra notes 56 and 60 (describing allowable assets under Exchange Act rule 18a-1).

<sup>72</sup> See para. (c)(1)(iii)(B)(I) of the proposed Amended Order.

<sup>73</sup> See, e.g., International Financial Reporting Standards Foundation (“IFRS”), IAS 7 Statement of Cash Flows (defining “cash” as comprising cash on hand and demand deposits and “cash equivalents” as short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value). See also Books and Records Adopting Release, 84 FR at 68673-74 (the section of the amended Part II of the FOCUS Report setting forth the assets side of the balance sheet and identifying cash as an allowable asset in Box 200).

category of liquid assets would be collateralized agreements.<sup>74</sup> These assets would consist of secured financings where securities serve as collateral such as repurchase agreements and securities loaned transactions.<sup>75</sup> The third category of liquid assets would be customer and other trading related receivables.<sup>76</sup> These assets would consist of customer margin loans, receivables from broker-dealers, receivables related to fails to deliver, and receivables from clearing organizations.<sup>77</sup> The fourth category of liquid assets would be trading and financial assets.<sup>78</sup> These assets would consist of cash market securities positions and listed and over-the-counter derivatives positions.<sup>79</sup>

As discussed above, initial margin posted to a counterparty is treated differently under Exchange Act rule 18a-1 and the Basel capital standard. The fifth category of liquid assets would be initial margin posted by the Covered Entity to a counterparty or a third-party custodian, provided: (1) the initial margin requirement is funded by a fully executed written loan agreement with an affiliate of the Covered Entity; (2) the loan agreement provides that the lender waives repayment of the loan until the initial margin is returned to the Covered Entity; and (3) the liability

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<sup>74</sup> See para. (c)(1)(iii)(B)(2) of the proposed Amended Order.

<sup>75</sup> See Books and Records Adopting Release, 84 FR at 68673-74 (the section of the amended Part II of the FOCUS Report setting forth the assets side of the balance sheet and identifying securities borrowed as an allowable asset in Boxes 240 and 250 and securities purchased under agreements to resell as an allowable asset in Box 360).

<sup>76</sup> See para. (c)(1)(iii)(B)(3) of the proposed Amended Order.

<sup>77</sup> See Books and Records Adopting Release, 84 FR at 68673-74 (the section of the amended Part II of the FOCUS Report setting forth the assets side of the balance sheet and identifying fails to deliver as allowable assets in Boxes 220 and 230, receivables from clearing organizations as allowable assets in Boxes 280 and 290, and receivables from customers as allowable assets in Boxes 310, 320, and 330).

<sup>78</sup> See para. (c)(1)(iii)(B)(4) of the proposed Amended Order.

<sup>79</sup> See Books and Records Adopting Release, 84 FR at 68673-74 (the section of the amended Part II of the FOCUS Report setting forth the assets side of the balance sheet and identifying securities, commodities, and swaps positions as allowable assets in Box 12019).

of the Covered Entity to the lender can be fully satisfied by delivering the collateral serving as initial margin to the lender.<sup>80</sup> As discussed above, one critical difference between Exchange Act rule 18a-1 and the Basel capital standard is that an SBS Entity cannot count as capital the amount of initial margin posted to a counterparty or third-party custodian unless it enters into a special loan agreement with an affiliate.<sup>81</sup> Under the Basel capital standard, a Covered Entity can count initial margin posted away as capital without the need to enter into a special loan arrangement with an affiliate. Consequently, to count initial margin posted away as a liquid asset for purposes of this capital condition, the Covered Entity would be required to enter into the same type of special agreement that an SBS Entity must execute to count initial margin as an allowable asset for purposes of Exchange Act rule 18a-1.<sup>82</sup>

If an asset does not fall within one of the five categories of “liquid assets” as defined in the proposed Amended Order,<sup>83</sup> it would be considered non-liquid, and could not be treated as a liquid asset for purposes of this capital condition. For example, the following categories of assets generally could not be treated as liquid assets: (1) investments; (2) loans; and (3) other assets. The non-liquid “investment” category would include the Covered Entity’s ownership interests in subsidiaries or other affiliates. The non-liquid “loans” category would include unsecured loans and advances. The non-liquid “other” assets category would refer to assets that do not fall into any of the other categories of liquid or non-liquid assets. These non-liquid

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<sup>80</sup> See para. (c)(1)(iii)(B)(5) of the proposed Amended Order.

<sup>81</sup> See Capital and Margin Adopting Release, 84 FR at 43887-88.

<sup>82</sup> Id.

<sup>83</sup> See para. (c)(1)(iii)(B) of the proposed Amended Order.



“other” assets would include furniture, fixtures, equipment, real estate, property, leasehold improvements, deferred tax assets, prepayments, and intangible assets.

As discussed above, the first prong of this capital condition would require the Covered Entity to subtract total liabilities from total liquid assets and then apply a deduction (haircut) to the difference.<sup>84</sup> The amount remaining after the deduction would need to equal or exceed \$20 million. The method of calculating the amount of the deduction would rely on the calculations Covered Entities must make under the Basel capital standard.<sup>85</sup> In particular, under the Basel standard, Covered Entities must risk-weight their assets. This involves adjusting the nominal value of each asset based on the inherent risk of the asset. Less risky assets are adjusted to lower values (*i.e.*, have less weight) than more risky assets. As a result, Covered Entities must hold lower levels of regulatory capital for less risky assets and higher levels of capital for riskier assets. Similarly, under Exchange Act rule 18a-1, less risky assets incur lower haircuts than riskier assets and, therefore, require less net capital to be held in relation to them. Consequently, the process of risk-weighting assets under the Basel capital standard provides a method to account for the inherent risk in an asset held by a Covered Entity similar to how the haircuts under the Exchange Act rule 18a-1 account for the risk of assets held by SBS Entities. For these reasons, the Commission preliminarily believes it would be appropriate to use the process of risk-weighting assets under the Basel capital standard to determine the amount of the deduction (haircuts) under the first prong of the third additional capital condition.

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<sup>84</sup> See para. (c)(1)(iii)(A)(I) of the proposed Amended Order.

<sup>85</sup> See BCBS, Risk-based capital requirements (RBC20), available at: [https://www.bis.org/basel\\_framework/chapter/RBC/20.htm?inforce=20191215&published=20191215](https://www.bis.org/basel_framework/chapter/RBC/20.htm?inforce=20191215&published=20191215).

Under the Basel capital standard, Covered Entities must hold regulatory capital equal to at least 8% of the amount of their risk-weighted assets.<sup>86</sup> Therefore, the deduction (haircut) required for purposes of this capital condition would be determined by dividing the amount of the Covered Entity's risk-weighted assets by 12.5 (i.e., the reciprocal of 8%).<sup>87</sup> In sum, the Covered Entity would be required to maintain an excess of liquid assets over total liabilities that equals or exceeds \$100 million before the deduction (derived from the firm's risk-weighted assets) and \$20 million after the deduction.<sup>88</sup>

The second prong of this capital condition would require the Covered Entity to make and preserve for three years a quarterly record that: (1) identifies and values the liquid assets maintained pursuant to the first prong; (2) compares the amount of the aggregate value the liquid assets maintained pursuant to the first prong to the amount of the Covered Entity's total liabilities and shows the excess liquid assets amount; and (3) shows the amount of the deduction

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<sup>86</sup> Id.

<sup>87</sup> See para. (c)(1)(iii)(C) of the proposed Amended Order. The Commission acknowledges that a Covered Entity's risk-weighted assets will include components in addition to market and credit risk charges (e.g., operational risk charges). However, the Commission expects the combined market and credit risk charges would make up the substantial majority of the risk-weighted assets. In addition, the Commission believes that this method of calculating the deduction in the first prong of the third additional capital condition is a reasonable approach in that it addresses market and credit risk similar to the process used by security-based swap dealers authorized to use internal models to compute market and credit risk deductions under Exchange Act rule 18a-1. See, e.g., Exchange Act rule 18a-1(e) (prescribing requirements to calculate market and credit risk charges, including use of an 8% multiplication factor for calculating the credit risk charges).

<sup>88</sup> For example, assume a Covered Entity has total assets of \$600 million (of which \$595 million are liquid and \$5 million are illiquid) and total liabilities of \$450 million. In this case, the Covered Entity's liquid assets would exceed total liabilities by \$145 million (\$590 million minus \$450 million) and, therefore, the Covered Entity would have excess liquid assets greater than \$100 million as required by the first prong of this capital condition. Assume further that the Covered Entity's risk-weighted assets under the Basel capital standard equal \$400 million. In this case, the Covered Entity's deduction would equal \$32 million (\$400 million divided by 12.5). Subtracting \$32 million from \$145 million leaves \$113 million, which exceeds \$20 million. Therefore, the Covered Entity would meet the second requirement of the first prong of this capital condition.

required under the first prong and the amount that deduction reduces the excess liquid assets amount.<sup>89</sup> Consequently, the quarterly record would include details showing whether the Covered Entity is meeting the \$100 million and \$20 million requirements of the first prong.

The third prong of this capital condition would require the Covered Entity to notify the Commission in writing within 24 hours in the manner specified on the Commission's website if the Covered Entity fails to meet the requirements of the first prong and include in the notice the contact information of an individual who can provide further information about the failure to meet the requirements.<sup>90</sup> As discussed above, the first additional capital condition would require the Covered Entity to apply substituted compliance with respect to notification requirements of Exchange Act rule 18a-8 relating to capital.<sup>91</sup> A Covered Entity applying substituted compliance with respect to Exchange Act rule 18a-8 under the proposed Amended Order would need to simultaneously submit to the Commission any notifications relating to capital that it must submit to the EU and German authorities. However, EU and German notification requirements do not address a failure to adhere to the simplified net liquid assets test that would be required by the first prong of this capital condition. Moreover, due to the differences between Exchange Act rule 18a-1 and the Basel capital standard discussed above, a Covered Entity could fall out of compliance with the requirements of the first prong but still remain in compliance with the requirements of the Basel capital standard. Accordingly, the third prong would require the Covered Entity to notify the Commission if the firm fails to meet the requirements of the first

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<sup>89</sup> See para. (c)(1)(iii)(A)(2) of the proposed Amended Order.

<sup>90</sup> See para. (c)(1)(iii)(A)(3) of the proposed Amended Order.

<sup>91</sup> See para. (c)(1)(ii) of the proposed Amended Order.

prong. This would alert the Commission of potential issues with the Covered Entity's financial condition that could pose risks to the firm's customers and counterparties.

The fourth prong of this condition would require the Covered Entity to include its most recently filed statement of financial condition (whether audited or unaudited) with its initial notice to the Commission of its intent to rely on substituted compliance.<sup>92</sup> This one-time obligation would provide the Commission with information about the assets, liabilities, and capital of Covered Entities applying substituted compliance with respect to Exchange Act rule 18a-1. The Commission would use the statement of financial condition and the periodic audited and unaudited reports Covered Entities would file with the Commission to monitor the appropriateness of the capital condition if it is included in an amended order. The Commission expects that most Covered Entities will file their initial notice of intent to apply substituted compliance with respect to Exchange Act rule 18a-1 at or around the time they file their registration applications with the Commission. Therefore, receipt of the statement of financial condition at that time would allow the Commission to begin this monitoring process before Covered Entities begin filing audited and unaudited reports with the Commission pursuant to Exchange Act rule 18a-7 or an amended order providing substituted compliance for Exchange Act rule 18a-7.<sup>93</sup>

C. Margin – preliminary views and proposed Amended Order

In the Commission's preliminary view, based on the Amended Application and the Commission's review of applicable provisions, relevant EU and German margin requirements would produce regulatory outcomes that are comparable to those associated with Exchange Act

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<sup>92</sup> See para. (c)(1)(iii)(A)(4) of the proposed Amended Order.

<sup>93</sup> See part VII.B.4, *infra* (discussing proposed reporting conditions with respect to applying substituted compliance for Exchange Act rule 18a-7).

rule 18a-3, provided Covered Entities are subject to additional conditions (discussed below) to address differences between the two margining regimes with respect to counterparty exceptions.

In terms of producing comparable outcomes, in adopting Exchange Act rule 18a-3, the Commission stated that it modified the proposal to more closely align the final rule with the margin rules of the Commodity Futures Trading Commission and the U.S. prudential regulators and, in doing so, with the recommendations made by the BCBS and the Board of the International Organization of Securities Commissions (“IOSCO”) with respect to margin requirements for non-centrally cleared derivatives.<sup>94</sup> In this regard, Exchange Act rule 18a-3 and the EU and German margin rules require firms to collect liquid collateral from a counterparty to cover variation and/or initial margin requirements.<sup>95</sup> Both sets of rules also require firms to deliver liquid collateral to a counterparty to cover variation margin requirements. Under both sets of rules, the fair market value of collateral used to meet a margin requirement must be reduced by a haircut.<sup>96</sup> Further, both sets of rules permit the use of a model (including a third party model such as ISDA’s SIMM™ model) to calculate initial margin.<sup>97</sup> The initial margin model under both sets of rules must meet certain minimum qualitative and quantitative requirements, including that the model must use a 99 percent, one-tailed confidence level with price changes equivalent to a 10-day movement in rates and prices.<sup>98</sup> Both sets of rules have

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<sup>94</sup> See Capital and Margin Adopting Release, 84 FR at 43908-09; see also BCBS/IOSCO, Margin Requirements for Non-centrally Cleared Derivatives (April 2020), available at: <https://www.bis.org/bcbs/publ/d499.pdf> (“BCBS/IOSCO Paper”). The EU and German margin requirements also are based on the recommendation in the BCBS/IOSCO Paper.

<sup>95</sup> See 17 CFR 240.18a-3(c)(1)(ii) and the Amended Application Annex A category 4 at 28-31.

<sup>96</sup> See 17 CFR 240.18a-3(c)(1)(ii) and the Amended Application Annex A category 4 at 38-39.

<sup>97</sup> See 17 CFR 240.18a-3(d)(2)(i) and the Amended Application Annex A category 4 at 12-18.

<sup>98</sup> See 17 CFR 240.18a-3(d)(2)(i) and the Amended Application Annex A category 4 at 12. The Commission must approve the use of an initial margin model. 17 CFR 240.18a-3(d)(2)(i). EMIR article 11(15) directs European supervisory authorities to develop regulatory technical standards

common exceptions to the requirements to collect and/or post initial or variation margin, including exceptions for certain commercial end users, the Bank for International Settlements, and certain multilateral development banks.<sup>99</sup> Both sets of rules also permit a threshold below which initial margin is not required to be collected and incorporate a minimum transfer amount.<sup>100</sup> For these reasons, substituted compliance with respect to Exchange Act rule 18a-3 would be conditioned on Covered Entities being subject to and complying with these EU and German margin requirements.<sup>101</sup>

However, there would be additional conditions to address differences in the exceptions to collecting variation and/or initial margin between Exchange Act rule 18a-3 and the EU and German margin rules. In this regard, the Commission stated when proposing Exchange Act rule 18a-3 that the “Dodd-Frank Act seeks to address the risk of uncollateralized credit risk exposure arising from OTC derivatives by, among other things, mandating margin requirements for non-cleared security-based swaps and swaps.”<sup>102</sup> Further, the comparability criteria for margin requirements under Exchange Act rule 3a71-6 provides that prior to making a substituted

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under which initial margin models have to be approved (initial and ongoing approval). EU and German requirements currently provide that, upon request, counterparties using an initial margin model shall provide the regulators with any documentation relating to the risk management procedures relating to such model at any time. EMIR Margin RTS article 2(6).

<sup>99</sup> See 17 CFR 240.18a-3(c)(1)(iii) and the Amended Application Annex A category 4 at 54-63.

<sup>100</sup> See 17 CFR 240.18a-3(c)(1)(iii) and the Amended Application Annex A category 4 at 64-66.

<sup>101</sup> See para. (c)(2)(i) of the proposed Amended Order. In connection with margin requirements, Covered Entities would need to comply with: EMIR article 11; EMIR Margin RTS; CRR articles 103, 105(3); 105(10); 111(2), 224, 285, 286, 286(7), 290, 295, 296(2)(b), 297(1), 297(3), and 298(1); MiFID Org Reg article 23(1); CRD articles 74 and 79(b); and KWG section 25a(1). See para. (c)(2)(i) of the proposed Amended Order.

<sup>102</sup> See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers; Proposed Rule, Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70214, 70258 (Nov. 23, 2012).

compliance determination, the Commission intends to consider (in addition to any conditions imposed) whether the foreign financial regulatory system requires registrants to adequately cover their current and future exposure to OTC derivatives counterparties, and ensures registrants' safety and soundness, in a manner comparable to the applicable provisions arising under the Exchange Act and its rules and regulations.<sup>103</sup> In adopting this comparability criteria for margin requirements, the Commission stated that obtaining collateral is one of the ways OTC derivatives dealers manage their credit risk exposure to OTC derivatives counterparties.<sup>104</sup>

To address the risk of uncollateralized exposures, Exchange Act rule 18a-3 requires SBS Entities without a prudential regulator to collect variation margin from all counterparties, including affiliates, unless an exception applies.<sup>105</sup> Under the EU and German margin requirements, there are exceptions from the variation margin requirements for certain intragroup transactions (i.e., transactions between affiliates).<sup>106</sup> In addition, Exchange Act rule 18a-3 requires firms to collect initial margin from all counterparties, unless an exception applies.<sup>107</sup> This initial margin requirement under Exchange Act rule 18a-3 requires the firm to collect initial margin from a financial counterparty such as a hedge fund without regard to whether the counterparty has material exposures to non-cleared security-based swaps and uncleared swaps.

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<sup>103</sup> See 17 CFR 240.3a71-6(d)(5)(i) and (ii).

<sup>104</sup> See Capital and Margin Adopting Release, 84 FR at 43949 (“Obtaining collateral is one of the ways OTC derivatives dealers manage their credit risk exposure to OTC derivatives counterparties. Prior to the financial crisis, in certain circumstances, counterparties were able to enter into OTC derivatives transactions without having to deliver collateral. When “trigger events” occurred during the financial crisis, those counterparties faced significant liquidity strains when they were required to deliver collateral.”). Id.

<sup>105</sup> See 17 CFR 240.18a-3(c)(ii)(A)(1) and (2).

<sup>106</sup> See the Amended Application Annex A category 4 at 60-61.

<sup>107</sup> See 17 CFR 240.18a-3(c)(ii)(B).

In contrast, EU and German margin requirements do not require Covered Entities to collect initial margin from financial counterparties, if their notional exposure to non-centrally cleared derivatives does not exceed a certain threshold on a group basis.<sup>108</sup>

In some cases these differences may result in a Covered Entity not being adequately collateralized to cover its current or future exposure to these counterparties with respect to its OTC derivatives transactions. In addition, differences in the counterparty exceptions could potentially incentivize market participants to engage in non-cleared security-based swap transactions outside of the United States.<sup>109</sup> Consequently, the Commission preliminarily believes it would be appropriate to propose additional margin conditions to produce comparable regulatory outcomes in terms of counterparty exceptions between Exchange Act rule 18a-3 and the EU and German requirements.

The first additional condition is designed to address differences in the counterparty exceptions with respect to variation margin. It would require a Covered Entity to collect variation margin, as defined in the EMIR Margin RTS, from a counterparty with respect to a transaction in non-cleared security-based swaps, unless the counterparty would qualify for an exception under Exchange Act rule 18a-3 from the requirement to deliver variation margin to the

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<sup>108</sup> See the Amended Application Annex A category 4 at 7 and 63. These thresholds are being phased-in with the last initial margin threshold set at EUR 8 billion.

<sup>109</sup> The Commission recognizes there are also cases where the EU and German margin rules are more restrictive than Exchange Act rule 18a-3. EU margin rules require Covered Entities to post initial margin to covered counterparties, while the Exchange Act rule 18a-3 would permit posting but not require it. In addition, EU margin rules also require a Covered Entity to collect (and post) initial margin to financial and non-financial counterparties if their notional exposure to non-centrally cleared derivatives exceeds a certain threshold on a group basis. In contrast, Exchange Act rule 18a-3 does not require (but permits) a nonbank security-based swap dealer to collect initial margin from counterparties that are financial market intermediaries. 17 CFR 240.18a-3(c)(1)(iii)(B). The comparability analysis, however, focuses on determining whether the EU and German margin rules are comparable to Exchange Act rule 18a-3.



Covered Entity.<sup>110</sup> This condition would define variation margin by referencing EMIR Margin RTS to facilitate implementation of the condition by Covered Entities. Under this condition, for example, Covered Entities would be required to collect variation margin from their affiliates, but would be permitted to comply with all other EU and German margin requirements, including calculation, collateral, documentation, and timing of collection requirements. The first proposed additional condition would close the gap between the counterparty exceptions of Exchange Act rule 18a-3 and the EU and German margin rules with respect to variation margin.

The second proposed additional condition is designed to address the counterparty exceptions with respect to initial margin. It would require a Covered Entity to collect initial margin, as defined in the EMIR Margin RTS, from a counterparty with respect to transactions in non-cleared security-based swaps, unless the counterparty would qualify for an exception under Exchange Act rule 18a-3 from the requirement to deliver initial margin to a Covered Entity.<sup>111</sup> The condition would define initial margin by referencing EMIR Margin RTS to facilitate implementation of the condition by Covered Entities. Under this condition, for example, Covered Entities would be required to collect initial margin from their certain counterparties, but would be permitted to comply with all other EU and German margin requirements, including calculation, collateral, documentation, and timing of collection requirements. The second proposed additional condition would close the gap between the counterparty exceptions of Exchange Act rule 18a-3 and the EU and German margin rules with respect to initial margin.

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<sup>110</sup> See para. (c)(2)(ii) of the proposed Amended Order. This proposed additional condition is included in the French and UK Orders. See French Order, 86 FR at 41659; UK Order, 86 FR at 43372.

<sup>111</sup> See para. (c)(2)(iii) of the proposed Amended Order. This proposed additional condition is included in the French and UK Orders. See French Order, 86 FR at 41659; UK Order, 86 FR at 43372.

Finally, the proposed Amended Order also includes as a proposed margin condition that the Covered Entity apply substituted compliance with respect to Exchange Act rule 18a-5(a)(12) (a record making requirement).<sup>112</sup> This record making requirement is directly linked to the margin requirements of Exchange Act rule 18a-3. The proposed Amended Order conditions substituted compliance with respect to this record making requirement on the Covered Entity applying substituted compliance with respect to Exchange Act rule 18a-3.<sup>113</sup> This condition would do the reverse: condition substituted compliance with respect to Exchange Act rule 18a-3 on the Covered Entity applying substituted compliance with respect to Exchange Act rule 18a-5(a)(12). This condition is designed to provide clarity as to the Covered Entity’s obligations under this record making requirement when applying substituted compliance with respect to Exchange Act rule 18a-3 pursuant this proposed Amended Order.

## **V. Proposed Amendments related to CCO Reports**

### **A. Compliance report certifications**

Rule 15Fk-1 states that the required reports must include “a certification by the chief compliance officer or senior officer that, to the best of his or her knowledge and reasonable belief and under penalty of law, the information contained in the compliance report is accurate and complete in all material respects.”<sup>114</sup> The standard applied in the Order required certification that “under penalty of law, the report is accurate and complete.”<sup>115</sup> The Commission

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<sup>112</sup> See para. (c)(2)(iv) of the proposed Amended Order. This proposed additional condition is included in the French and UK Orders. See French Order, 86 FR at 41659; UK Order, 86 FR at 43372.

<sup>113</sup> See para. (f)(1)(i)(L) of the proposed Amended Order.

<sup>114</sup> Exchange Act rule 15Fk-1(c)(2)(ii)(D) ; see also Exchange Act rule 15Fk-1(e)(2) (defining “senior officer” as “the chief executive officer or other equivalent officer”).

<sup>115</sup> See para. (d)(2) of the Order.

preliminarily believes that, consistent with the French Order,<sup>116</sup> further alignment of the proposed Amended Order's certification requirement with that of the applicable Exchange Act rule is appropriate. Therefore, the proposed Amended Order would clarify that the required reports should be certified by "the chief compliance officer or senior officer" of the Covered Entity and that the same certification standard contained in Exchange Act rule 15Fk-1 would apply.<sup>117</sup>

B. Timing of compliance report submission

Also consistent with the French Order,<sup>118</sup> the Commission is proposing to amend the Order to clarify the timing for Covered Entities to submit compliance reports to the Commission. To promote timely notice comparable to what the Exchange Act rule provides, the Commission is proposing to incorporate a timing standard that accounts for MiFID-required timing as well as the possibility that the relevant reports may be submitted to the management body early. Under the proposed Amended Order, the applicable compliance reports must be provided to the Commission no later than 15 days following the earlier of: (i) the submission of the report to the Covered Entity's management body; or (ii) the time the report is required to be submitted to the management body.<sup>119</sup> The proposed Amended Order would also clarify that together the reports must cover the entire period that the Covered Entity's annual compliance report referenced in Exchange Act section 15F(k)(3) and Exchange Act rule 15Fk-1(c) would be required to cover.<sup>120</sup>

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<sup>116</sup> See French Order, 86 FR at 41659.

<sup>117</sup> See para. (d)(2)(ii)(B) of the proposed Amended Order. In addition, for consistency with the French Order, the Commission is proposing to incorporate CRR articles 286-88 and 293 and EMIR Margin RTS article 2 as part of para. (d)(3) of the proposed Amended Order.

<sup>118</sup> See French Order, 86 FR at 41659.

<sup>119</sup> See para. (d)(2)(D) of the proposed Amended Order.

<sup>120</sup> See para. (d)(2)(E) of the proposed Amended Order.

## **VI. Proposed Amendments Counterparty Protection Requirements**

### **A. Disclosure of Information regarding Material Risks and Characteristics**

The Commission is proposing to add two requirements to the list of German and EU disclosure of information regarding material incentives or conflicts of interest requirements that the Covered Entity must be subject to and comply with. The MAR Investment Recommendations Regulation articles 5 and 6 enumerate specific obligations in relation to disclosure of interests or of conflicts of interest. Article 5 requires that persons who produce recommendations disclose in their recommendations all relationships and circumstances that may reasonably be expected to impair the objectivity of the recommendation, including interests or conflicts of interest. Article 6 imposes additional obligations on certain entities, including the disclosure of information on their interests and conflicts of interest concerning the issuer to which a recommendation relates. The Commission preliminarily believes that requiring Covered Entities to be subject to and comply with MAR Investment Recommendations Regulation articles 5 and 6 contributes to a determination that relevant German and EU requirements produce regulatory outcomes that are comparable to relevant requirements of Exchange Act rule 15Fh-3(b).

### **B. Fair and Balanced Communications**

The Commission is also proposing to modify the fair and balanced communications section of the proposed Amended Order.<sup>121</sup> First, the Commission believes that German and EU fair and balanced communications requirements are more comparable to Exchange Act requirements when considering three additional EU requirements: MAR article 20(1) would require the Covered Entity to present recommendations in a manner that ensures the information

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<sup>121</sup> See para. (e)(2)(iii) of the proposed Amended Order.

is objectively presented and to disclose interests and conflicts of interest concerning the financial instruments to which the information relates. MAR Investment Recommendations Regulation article 3 would require a Covered Entity to communicate only recommendations that present facts in a way that they are clearly distinguished from interpretations, estimates, opinions and other types of non-factual information; label clearly and prominently projections, forecasts and price targets; indicate the relevant material assumptions and substantial material sources of information; and include only reliable information or a clear indication when there is doubt about reliability. MAR Investment Recommendations Regulation article 4 would require the Covered Entity to provide in its recommendation additional information about the factual basis of its recommendation. Accordingly, the Commission is adding these three requirements to the Order's list of German and EU fair and balanced communications requirements that the Covered Entity must be subject to and comply with.<sup>122</sup> Second, the Order required the Covered Entity to be subject to and comply with MAR Investment Recommendations Regulation article 5,<sup>123</sup> which relates to obligations to disclose conflicts of interest. As discussed above, the Commission is requiring Covered Entities to comply with this requirement and with MAR Investment Recommendations Regulation article 6 when using substituted compliance for disclosure of material incentives and conflicts of interest requirements. Accordingly, the Commission believes that MAR Investment Recommendations Regulation article 5 is less relevant to comparability of fair and balanced communications requirements and is proposing to delete the reference to it in relation to substituted compliance for fair and balanced communications.

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<sup>122</sup> See para. (e)(5) of the Order.

<sup>123</sup> See para. (d)(2) of the Order

## VII. Proposed Amendments related to Recordkeeping, Reporting, Notification, and Securities Count Requirements

### A. BaFin request and associated analytic considerations

In its initial application (the “BaFin Application”), in part, requests substituted compliance for requirements applicable to SBS Entities with and without a prudential regulator under the Exchange Act relating to:

- Recordmaking – Exchange Act rule 18a-5 requires prescribed records to be made and kept current.<sup>124</sup>
- Record Preservation – Exchange Act rule 18a-6 requires preservation of records.<sup>125</sup>
- Reporting – Exchange Act rule 18a-7 requires certain reports.<sup>126</sup>
- Notification – Exchange Act rule 18a-8 requires notification to the Commission when certain financial or operational problems occur.<sup>127</sup>

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<sup>124</sup> See 17 CFR 240.18a-5. The BaFin Application discusses German requirements that address firms’ record creation obligations related to matters such as financial condition, operations, transactions, counterparties and their property, personnel and business conduct. See BaFin Application Annex A category 2 at 4-34.

<sup>125</sup> See 17 CFR 240.18a-6. The BaFin Application discusses German requirements that address firms’ record preservation obligations related to records that firms are required to create, as well as additional records such as records of communications. See BaFin Application Annex A category 2 at 35-79.

<sup>126</sup> See 17 CFR 240.18a-7. The BaFin Application discusses German requirements that address firms’ obligations to make certain reports. See BaFin Application Annex A category 2 at 80-91, 96-102.

<sup>127</sup> See 17 CFR 240.18a-8. The BaFin Application discusses German requirements that address firms’ obligations to make certain notifications. See BaFin Application Annex A category 2 at 92-96, 102.

- Securities Count – Exchange Act rule 18a-9 requires non-prudentially regulated security-based swap dealers to perform a quarterly securities count.<sup>128</sup>
- Daily Trading Records Exchange Act section 15F(g) requires SBS Entities to maintain daily trading records.<sup>129</sup>

Taken as a whole, the recordkeeping, reporting, notification, and securities count requirements that apply to SBS Entities are designed to promote the prudent operation of the firm's security-based swap activities, assist the Commission in conducting compliance examinations of those activities, and alert the Commission to potential financial or operational problems that could impact the firm and its customers.

B. Preliminary views and proposed Amended Order

1. General considerations

In issuing the Order, the Commission found that relevant EU and German requirements, subject to conditions and limitations, would produce regulatory outcomes that are comparable to the outcomes associated with the recordkeeping, reporting, and notification requirements of Exchange Act rules 18a-5, 18a-6, 18a-7, and 18a-8 applicable to SBS Entities with a prudential regulator. However, the BaFin Application did not seek substituted compliance for the Exchange Act capital and margin requirements applicable to SBS Entities without a prudential regulator. Because of the close relationship between many of the Exchange Act recordkeeping, reporting, and notification requirements and the administration and oversight of Exchange Act

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<sup>128</sup> See 17 CFR 240.18a-9. The BaFin Application discusses German requirements that address firms' obligations to perform securities counts. See BaFin Application Annex A category 2 at 27-30.

<sup>129</sup> See 15 U.S.C. 78o-10(g). The BaFin Application discusses German requirements that address firms' record preservation obligations related to records that firms are required to create, as well as additional records such as records of communications. See BaFin Application Annex A category 2 at 35-79.

capital and margin requirements, the Order did not address substituted compliance for recordkeeping, reporting, notification, and securities count requirements applicable to SBS Entities without a prudential regulator. The Commission is now considering substituted compliance for these Exchange Act requirements because the Amended Application requests substituted compliance for the Exchange Act capital and margin requirements applicable to SBS Entities without a prudential regulator. The Commission also is considering substituted compliance with respect to the trading record preservation requirements of Exchange Act section 15F(g), which are applicable to SBS Entities with and without a prudential regulator.

The Commission preliminarily concludes that the relevant EU and German requirements, subject to conditions and limitations, would produce regulatory outcomes that are comparable to the outcomes associated with the requirements of Exchange Act rules 18a-5, 18a-6, 18a-7, 18a-8, and 18a-9 applicable to SBS Entities without a prudential regulator and to the outcomes associated with Exchange Act section 15F(g) applicable to all SBS Entities. In reaching this preliminary conclusion, the Commission recognizes that there are certain differences between the EU and German requirements and the Exchange Act requirements. In the Commission's preliminary view, on balance, those differences generally would not be inconsistent with substituted compliance for these requirements. Requirement-by-requirement similarity is not needed for substituted compliance.

The Order makes substituted compliance available with respect to the entirety of Exchange Act rules 18a-5, 18a-6, 18a-7, and 18a-8 as applicable to Covered Entities with a prudential regulator. Consequently, under the Order, the Covered Entity can elect to apply substituted compliance with respect to the entire rule (subject to conditions and limitations) or, alternatively, comply with the Exchange Act rule. The proposed Amended Order would modify



this approach to provide all Covered Entities with greater flexibility to select which distinct requirements within the broader rule for which they would apply substituted compliance. This would not preclude a Covered Entity from applying substituted compliance for the entire rule (subject to conditions and limitations). However, it would permit the Covered Entity to apply substituted compliance with respect to certain requirements of a given rule and to comply directly with the remaining requirements. This more granular approach to making substituted compliance determinations with respect to discrete requirements within Exchange Act rules 18a-5, 18a-6, 18a-7, and 18a-8 (collectively, the “recordkeeping, reporting, and notification rules”) is intended to permit Covered Entities to leverage existing recordkeeping and reporting systems that are designed to comply with the broker-dealer recordkeeping and reporting requirements on which the recordkeeping, reporting, and notification requirements applicable to SBS Entities are based. For example, it may be more efficient for a Covered Entity to comply with certain Exchange Act requirements within a given recordkeeping, reporting, or notification rule (rather than apply substituted compliance) because it can utilize systems that its affiliated broker-dealer has implemented to comply with them. This proposed approach is consistent with the approach taken by the Commission in the French and UK Orders.<sup>130</sup>

As applied to Exchange Act rules 18a-5 and 18a-6, this approach of providing greater flexibility results in preliminary substituted compliance determinations with respect to the different categories of records these rules require SBS Entities to make, keep current, and/or preserve. The objective of these rules – taken as a whole – is to assist the Commission in monitoring and examining for compliance with substantive Exchange Act requirements

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<sup>130</sup> See French Order, 86 FR at 41649; UK Order, 86 FR at 43360.

applicable to SBS Entities (e.g., capital and margin requirements) as well as to promote the prudent operation of these firms.<sup>131</sup> The Commission preliminarily believes the comparable EU and German recordkeeping rules achieve these outcomes with respect to compliance with substantive EU and German requirements for which preliminary positive substituted compliance determinations are being made in this proposed Amended Order (e.g., the preliminary positive substituted compliance determinations with respect to the Exchange Act capital and margin requirements). At the same time, the recordkeeping rules address different categories of records through distinct requirements within the rules. Each requirement with respect to a specific category of records (e.g., paragraph (a)(2) of Exchange Act rule 18a-5 addressing ledgers (or other records) reflecting all assets and liabilities, income and expense and capital accounts) can be viewed in isolation as a distinct recordkeeping rule. Therefore, it may be appropriate to make substituted compliance determinations at this level of Exchange Act rules 18a-5 and 18a-6.

As discussed in more detail below, the Commission's preliminary view is that substituted compliance is appropriate for most of the requirements within the recordkeeping, reporting, and notification rules. However, certain of the discrete requirements in these rules are fully or partially linked to substantive Exchange Act requirements for which substituted compliance is not available or for which a positive substituted compliance determination would not be made under the proposed Amended Order. In these cases, a preliminary positive substituted compliance determination would not be made for the requirement that is fully linked to the substantive requirement or to the part of the requirement that is linked to the substantive requirement. In particular, a preliminary positive substituted compliance determination would

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<sup>131</sup> See, e.g., Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25194, 25199-200 (May 2, 2014).

not be made, in full or in part, for recordkeeping, reporting, or notification requirements linked to the following Exchange Act rules for which substituted compliance is not available or a positive substituted compliance determination would not be made: (1) Exchange Act rule 15Fh-4 (“Rule 15Fh-4 Exclusion”); (2) Exchange Act rule 15Fh-5 (“Rule 15Fh-5 Exclusion”); (3) Exchange Act rule 15Fh-6 (“Rule 15Fh-6 Exclusion”); (4) Exchange Act rule 18a-2 (“Rule 18a-2 Exclusion”); (5) Exchange Act rule 18a-4 (“Rule 18a-4 Exclusion”); (6) Regulation SBSR (“Regulation SBSR Exclusion”); and (7) Form SBSE and its variations (“Form SBSE Exclusion”). This proposed approach is consistent with the approach taken by the Commission in the French and UK Orders.<sup>132</sup>

In addition, certain of the requirements in the recordkeeping, reporting, and notification rules are expressly linked to substantive Exchange Act requirements where a preliminary positive substituted compliance determination would be made under the proposed Amended Order. In these cases, substituted compliance with the linked requirement in the recordkeeping, reporting, or notification rule would be conditioned on the Covered Entity applying substituted compliance to the linked substantive Exchange Act requirement. This would be the case regardless of whether the requirement is fully or partially linked to the substantive Exchange Act requirement. The recordkeeping, reporting, and notification requirements that are linked to a substantive Exchange Act requirement are designed and tailored to assist the Commission in monitoring and examining an SBS Entity’s compliance with the substantive Exchange Act requirement. EU and German recordkeeping, reporting, and notification requirements are designed to perform a similar role with respect to the substantive EU and German requirements to which they are linked. Consequently, this condition would be designed to ensure that the

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<sup>132</sup> See French Order, 86 FR at 41650; UK Order, 86 FR at 43361.

records, reports, and notifications of a Covered Entity align with the substantive Exchange Act or EU or German requirement to which they are linked. For these reasons, under the proposed Amended Order, substituted compliance for recordkeeping, reporting, and notification requirements linked to the following Exchange Act rules would be conditioned on the Covered Entity applying substituted compliance to the linked substantive Exchange Act rule: (1) Exchange Act rule 15Fh-3 (“Rule 15Fh-3 Condition”); (2) Exchange Act rule 15Fi-2 (“Rule 15Fi-2 Condition”); (3) Exchange Act rule 15Fi-3 (“Rule 15Fi-3 Condition”); (4) Exchange Act rule 15Fi-4 (“Rule 15Fi-4 Condition”); (5) Exchange Act rule 15Fi-5 (“Rule 15Fi-5 Condition”); (6) Exchange Act rule 15Fk-1 (“Rule 15Fk-1 Condition”); (7) Exchange Act rule 18a-1 (“Rule 18a-1 Condition”); (8) Exchange Act rule 18a-3 (“Rule 18a-3 Condition”); (9) Exchange Act rule 18a-5 (“Rule 18a-5 Condition”) and (10) Exchange Act rule 18a-7 (“Rule 18a-7 Condition”). This proposed approach is consistent with the approach taken by the Commission in the French and UK Orders.<sup>133</sup>

Moreover, while certain recordkeeping and reporting requirements are not expressly linked to Exchange Act rule 18a-1, they would be important to the Commission’s ability to monitor or examine for compliance with the capital requirements of this rule. The records also would assist the firm in monitoring its net capital position and, therefore, in complying with Exchange rule 18a-1. Therefore, substituted compliance with respect to these recordkeeping and reporting requirements would be subject to the condition that the Covered Entity applies substituted compliance with respect to Exchange Act rule 18a-1 (i.e., the “Rule 18a-1 Condition”). This approach would be designed to ensure that, if the Covered Entity does not apply substituted compliance with respect to Exchange Act rule 18a-1, it makes and preserves

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<sup>133</sup> See French Order, 86 FR at 41650; UK Order, 86 FR at 43361.

records and files reports that the Commission uses to monitor and examine for compliance with the Exchange Act rule 18a-1, and that the firm makes and preserves records to assist it in complying with these rules.

Additionally, substituted compliance with respect to paragraphs (a)(1), (b), and (c) through (h) of Exchange Act rule 18a-7 would be subject to the additional condition that the Covered Entity applies substituted compliance with respect to Exchange Act rule 18a-6(b)(1)(viii) (the “Rule 18a-6(b)(1)(viii) Condition”). This record preservation requirement is directly linked to the financial and operational reporting requirements of paragraphs (a)(1), (b), and (c) through (h) of Exchange Act rule 18a-7 and this additional condition would be designed to provide clarity as to the Covered Entity’s obligations under this record preservation requirement when applying substituted compliance with respect to paragraphs (a)(1), (b), and (c) through (h) of Exchange Act rule 18a-7 pursuant to this proposed Amended Order. This proposed approach is consistent with the approach taken by the Commission in the French and UK Orders.<sup>134</sup>

## 2. Exchange Act Rule 18a-5

Exchange Act rule 18a-5 requires SBS Entities to make and keep current various types of records. The requirements for SBS Entities without a prudential regulator are set forth in paragraph (a) of the rule.<sup>135</sup> The requirements for SBS Entities with a prudential regulator are set forth in paragraph (b) of the rule.<sup>136</sup> The Order makes substituted compliance available for the requirements of paragraph (b) of Exchange At rule 18a-5 (subject to conditions and limitations).

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<sup>134</sup> See French Order, 86 FR at 41650; UK Order, 86 FR at 43361.

<sup>135</sup> See paras. (a)(1) through (18) of Exchange Act rule 18a-5.

<sup>136</sup> See paras. (b)(1) through (14) of Exchange Act rule 18a-6.

The Commission is making a preliminary positive substituted compliance determination for many of the requirements of paragraph (a) of Exchange Act rule 18a-5 and making preliminary positive substituted compliance determinations with respect to paragraph (b) in a more granular manner than the Order.<sup>137</sup>

However, certain of the requirements in these paragraphs are linked to substantive Exchange Act requirements for which substituted compliance is not available or a positive substituted compliance would not be made under the proposed Amended Order. In these cases, a positive substituted compliance determination would not be made for the linked requirement in Exchange Act rule 18a-5 or the portion of the requirement in Exchange Act rule 18a-5 that is linked to the substantive Exchange Act requirement.<sup>138</sup>

In addition, certain of the requirements in Exchange Act rule 18a-5 are fully or partially linked to substantive Exchange Act requirements where a preliminary positive substituted compliance determination would be made under the proposed Amended Order. In these cases, substituted compliance with the requirement in Exchange Act rule 18a-5 would be conditioned

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<sup>137</sup> See para. (f)(1) of the proposed Amended Order.

<sup>138</sup> A positive preliminary substituted compliance determination would not be made for the following requirements of Exchange Act rule 18a-5 because they are linked to a substantive Exchange Act requirement for which the proposed Amended Order would not provide substituted compliance: (1) the portion of Exchange Act rule 18a-5(a)(9) that relates to Exchange Act rule 18a-2 would be subject to the Rule 18a-2 Exclusion; (2) Exchange Act rules 18a-5(a)(13) and (14) and (b)(9) and (10) are fully linked to Exchange Act rule 18a-4 and, therefore, would be subject to the Rule 18a-4 Exclusion; (3) the portions of Exchange Act rules 18a-5(a)(16) and (b)(12) that relate to Exchange Act rule 15Fh-6 would be subject to the Rule 15Fh-6 Exclusion; (4) the portions of Exchange Act rules 18a-5(a)(17) and (b)(13) that relate to Exchange Act rule 15Fh-4 would be subject to the Rule 15Fh-4 Exclusion; and (5) the portions of Exchange Act rules 18a-5(a)(17) and (b)(13) that relate to Exchange Act rule 15Fh-5 would be subject to the 15Fh-5 Exclusion.

on the Covered Entity applying substituted compliance to the linked substantive Exchange Act requirement.<sup>139</sup>

Moreover, there are certain requirements in Exchange Act rule 18a-5 that are not expressly linked to Exchange Act rule 18a-1, but that would be important records in terms of the Commission's ability to examine for compliance with that rule, and the Covered Entity's ability to monitor its net capital position. Therefore, substituted compliance with respect to these requirements of Exchange Act rule 18a-5 would be subject to the condition that the Covered Entity applies substituted compliance for Exchange Act rule 18a-1 (i.e., the Rule 18a-1 Condition).<sup>140</sup>

In addition, the proposed Amended Order would allow a Covered Entity to apply substituted compliance on a transaction-by-transaction basis to the Commission's recordkeeping requirements that are linked with the counterparty protection requirements of Exchange Act rule 15Fh-3.<sup>141</sup> This approach would align with the proposed Amended Order allowing Covered

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<sup>139</sup> Substituted compliance with the following requirements of Exchange Act rule 18a-5 would be conditioned on the Covered Entity applying substituted compliance to the linked substantive Exchange Act requirement: (1) Exchange Act rules 18a-5(a)(6), (a)(15), (b)(6) and (b)(11) are linked to Exchange Act rule 15Fi-2 and, therefore, would be subject to the Rule 15Fi-2 Condition; (2) Exchange Act rule 18a-5(a)(9) is linked to Exchange Act rule 18a-1 and, therefore, would be subject to the Rule 18a-1 Condition; (3) Exchange Act rule 18a-5(a)(12) is linked to Exchange Act rule 18a-3 and, therefore, would be subject to the Rule 18a-3 Condition; (4) Exchange Act rules 18a-5(a)(17) and (b)(13) are linked to Exchange Act rule 15Fh-3 and, therefore, would be subject to the Rule 15Fh-3 Condition; (5) Exchange Act rules 18a-5(a)(17) and (b)(13) are linked to Exchange Act rule 15Fk-1 and, therefore, would be subject to the Rule 15Fk-1 Condition; (6) Exchange Act rules 18a-5(a)(18)(i) and (ii) and (b)(14)(i) and (ii) are linked to Exchange Act rule 15Fi-3 and, therefore, would be subject to the Rule 15Fi-3 Condition; and (7) Exchange Act rules 18a-5(a)(18)(iii) and (b)(14)(iii) are linked to Exchange Act rule 15Fi-4 and, therefore, would be subject to the Rule 15Fi-4 Condition.

<sup>140</sup> Substituted compliance with the requirements of Exchange Act rules 18a-5(a)(1), (2), (3), (4), (5), (7), (8), and (9) would be conditioned on the Covered Entity applying substituted compliance to Exchange Act rule 18a-1.

<sup>141</sup> See para. (f)(1)(ii)(B) of the proposed Amended Order.

Entities to apply substituted compliance on a transaction-by-transaction basis for the Commission's counterparty protection requirements.

Under the proposed Amended Order, substituted compliance in connection with the record making requirements of Exchange Act rule 18a-5 would be subject to the condition that the Covered Entity: (1) preserves all of the data elements necessary to create the records required by Exchange Act rules 18a-5(a)(1), (2), (3), (4), and (7) (if not prudentially regulated) or Exchange Act rules 18a-5(b)(1), (2), (3), and (7) (if prudentially regulated); and (2) upon request furnishes promptly to representatives of the Commission the records required by those rules ("SEC Format Condition").<sup>142</sup> This proposed condition is modeled on the alternative compliance mechanism in paragraph (c) of Exchange Act rule 18a-5. In effect, a Covered Entity applying substituted compliance with respect to these requirements of Exchange Act rule 18a-5 would need to comply with the comparable EU and German requirements. However, under the SEC Format Condition, the Covered Entity would need to produce a record that is formatted in accordance with the requirements of Exchange Act rule 18a-5 at the request of Commission staff. The objective would be to require – on a very limited basis – the production of a record that consolidates the information required by Exchange Act rules 18a-5(a)(1), (2), (3), (4), and (7) (if not prudentially regulated) or Exchange Act rules 18a-5(b)(1), (2), (3), and (7) (if prudentially regulated) in a single record and, as applicable, in a blotter or ledger format. This would assist the Commission staff in reviewing the information on the record.

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<sup>142</sup> See para. (f)(1)(ii)(A) of the proposed Amended Order. The Order includes this condition for a Covered Entity with a prudential regulator to apply substituted compliance for Exchange Act rule 18a-5. The proposed Amended Order would extend the scope of this condition to address Covered Entities without a prudential regulator applying substituted compliance for the requirements of Exchange Act rule 18a-5.



The following table summarizes the Commission’s preliminary positive substituted compliance determinations with respect to requirements of Exchange Act rule 18a-5 by listing in each row: (1) the paragraph of the proposed Amended Order that sets forth the preliminary determination; (2) the paragraph(s) of Exchange Act rule 18a-5 to which the preliminary determination applies; (3) a brief description of the records required by the paragraph(s); and (4) a brief description of any additional conditions to applying substituted compliance to the requirements, including any partial exclusions because portions of the requirements are linked to substantive Exchange Act requirements for which the proposed Amended Order would not provide substituted compliance.<sup>143</sup>

<b>Exchange Act rule 18a-5 (record making)</b>				
<b>Order Paragraph</b>	<b>Rule Paragraph</b>		<b>Rule Description</b>	<b>Additional Conditions and Partial Exclusions</b>
(f)(1)(i)(A)	(a)(1)	(b)(1)	Trade blotters	(1) SEC Format Condition (2) Rule 18a-1 Condition for ¶ (a)(1)
(f)(1)(i)(B)	(a)(2)		General ledger	(1) SEC Format Condition (2) Rule 18a-1 Condition for ¶ (a)(2)
(f)(1)(i)(C)	(a)(3)	(b)(2)	Account ledgers	(1) SEC Format Condition (2) Rule 18a-1 Condition for ¶ (a)(3)
(f)(1)(i)(D)	(a)(4)	(b)(3)	Stock record	(1) SEC Format Condition (2) Rule 18a-1 Condition for ¶ (a)(4)
(f)(1)(i)(E)		(b)(4)	Memoranda of brokerage orders	N/A
(f)(1)(i)(F)	(a)(5)	(b)(5)	Memoranda of proprietary orders	Rule 18a-1 Condition for ¶ (a)(5)
(f)(1)(i)(G)	(a)(6) (a)(15)	(b)(6) (b)(11)	Confirmations, trade verification	Rule 15Fi-2 Condition
(f)(1)(i)(H)	(a)(7)	(b)(7)	Accountholder information	(1) SEC Format Condition (2) Rule 18a-1 Condition for ¶ (a)(7)
(f)(1)(i)(I)	(a)(8)		Options positions	Rule 18a-1 Condition

<sup>143</sup> The table does not include the proposed conditions for applying substituted compliance to Exchange Act rule 18a-5; namely that the Covered Entity: (1) must be subject to and comply with specified requirements of foreign law; and (2) as discussed below, must promptly furnish to a representative of the Commission upon request an English translation of a record. See para. (f)(8) of the proposed Amended Order (setting forth the English translation requirement).

<b>Exchange Act rule 18a-5 (record making)</b>				
<b>Order Paragraph</b>	<b>Rule Paragraph</b>		<b>Rule Description</b>	<b>Additional Conditions and Partial Exclusions</b>
(f)(1)(i)(J)	(a)(9)		Trial balances, computation of net capital and tangible net worth	(1) Rule 18a-1 Condition (2) Rule 18a-2 Exclusion
(f)(1)(i)(K)	(a)(10)	(b)(8)	Associated person's employment application	N/A
(f)(1)(i)(L)	(a)(12)		Non-cleared margin rule calculations	Rule 18a-3 Condition
(f)(1)(i)(M)	(a)(17)	(b)(13)	Compliance with business conduct requirements	(1) Rule 15Fh-3 Condition (2) Rule 15Fk-1 Condition (3) Rule 15Fh-4 Exclusion (4) Rule 15Fh-5 Exclusion
(f)(1)(i)(N)	(a)(18)(i) (a)(18)(ii)	(b)(14)(i) (b)(14)(ii)	Portfolio reconciliation	Rule 15Fi-3 Condition
(f)(1)(i)(O)	(a)(18)(iii)	(b)(14)(iii)	Portfolio compression	Rule 15Fi-4 Condition

The following table summarizes the Commission's preliminary determinations with respect to requirements of Exchange Act rule 18a-5 for which a positive substituted compliance determination would not be made because they are fully linked to substantive Exchange Act requirements for which the proposed Amended Order would not provide substituted compliance by listing in each row: (1) the paragraph of the proposed Amended Order that sets forth the determination; (2) the paragraphs of Exchange Act rule 18a-5 to which the determination applies; (3) a brief description of the records required by the paragraphs; and (4) a brief description of why the requirement is excluded from substituted compliance.

<b>Exchange Act rule 18a-5 (record making)</b>				
<b>Order Paragraph</b>	<b>Rule Paragraph</b>		<b>Rule Description</b>	<b>Exclusion</b>
(f)(1)(ii)(C)	(a)(13)	(b)(9)	Possession or control records	Rule 18a-4 Exclusion
(f)(1)(ii)(C)	(a)(14)	(b)(10)	Reserve computations	Rule 18a-4 Exclusion
(f)(1)(ii)(C)	(a)(16)	(b)(12)	Political contribution records	Rule 15Fh-6 Exclusion

### 3. Exchange Act Rule 18a-6

Exchange Act rule 18a-6 requires an SBS Entity to preserve certain types of records if it makes or receives them (in addition to the records the SBS Entity is required to make and keep current pursuant to Exchange Act rule 18a-5).<sup>144</sup> Exchange Act rule 18a-6 also prescribes the time period that these additional records and the records required to be made and kept current pursuant to Exchange Act rule 18a-5 must be preserved and the manner in which they must be preserved.

Paragraphs (a) through (d) of Exchange Act rule 18a-6 identify the records that an SBS Entity must retain if it makes or receives them and prescribes the retention periods for these records as well as for the records that must be made and kept current pursuant to Exchange Act rule 18a-5. Certain of these paragraphs prescribe requirements separately for SBS Entities without a prudential regulator and SBS Entities with a prudential regulator.<sup>145</sup> The Order makes substituted compliance available for the requirements of these paragraphs applicable to SBS Entities with a prudential regulator. As discussed below, the Commission is making a preliminary positive substituted compliance determination for many of the requirements of these paragraphs applicable to SBS Entities without a prudential regulator. Further, the Commission is making preliminary positive substituted compliance determinations for many of the requirements

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<sup>144</sup> See 17 CFR 240.18a-6.

<sup>145</sup> Paras. (a)(1), (b)(1), (d)(2)(i), and (d)(3)(i) of Exchange Act rule 18a-6 apply to SBS Entities without a prudential regulator. Paras. (a)(2), (b)(2), (d)(2)(ii), and (d)(3)(ii) of Exchange Act rule 18a-6 apply to SBS Entities with a prudential regulator. Paras. (c), (d)(1), (d)(4), and (d)(5) of Exchange Act rule 18a-6 apply to SBS Entities irrespective of whether they have a prudential regulator.

of these paragraphs applicable to SBS Entities with a prudential regulator in a more granular manner than the Order.

However, certain of these requirements are fully or partially linked to substantive Exchange Act requirements for which a positive substituted compliance determination would not be made under the proposed Amended Order. In these cases, a positive substituted compliance determination would not be made for the linked requirement in Exchange Act rule 18a-6.<sup>146</sup>

In addition, certain of the requirements in Exchange Act rule 18a-6 are fully or partially linked to substantive Exchange Act requirements where a positive substituted compliance determination would be made under the proposed Amended Order. In these cases, substituted compliance with the requirement in Exchange Act rule 18a-6 would be conditioned on the Covered Entity applying substituted compliance to the linked substantive Exchange Act requirement.<sup>147</sup>

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<sup>146</sup> A positive substituted compliance determination would not be made for the following requirements of Exchange Act rule 18a-6 because they are linked to a substantive Exchange Act requirement for which the proposed Amended Order would not provide substituted compliance: (1) the portion of Exchange Act rule 18a-6(b)(1)(v) relating to Exchange Act rule 18a-2 would be subject to the Rule 18a-2 Exclusion; (2) Exchange Act rule 18a-6(b)(1)(viii)(L) is fully linked to Exchange Act Rule 18a-4 and, therefore, would be subject to the Rule 18a-4 Exclusion; (3) the portion of Exchange Act rule 18a-6(b)(1)(viii)(M) relating to Exchange Act rule 18a-2 would be subject to the Rule 18a-2 Exclusion; (4) Exchange Act rules 18a-6(b)(1)(xi) and (b)(2)(vi) are fully linked to Regulation SBSR and, therefore, would be subject to the Regulation SBSR Exclusion; (5) Exchange Act rules 18a-6(b)(1)(xiii) and 18a-6(b)(2)(viii) are fully linked to Exchange Act rules 15Fh-4 and, therefore, would be subject to the Rule 15Fh-4 Exclusion; (6) Exchange Act rules 18a-6(b)(1)(xiii) and 18a-6(b)(2)(viii) are fully linked to Exchange Act rule 15Fh-5 and, therefore, would be subject to the Rule 15Fh-5 Exclusion; (7) Exchange Act rule 18a-6(b)(2)(v) is fully linked to Exchange Act rule 18a-4 and, therefore, would be subject to the Rule 18a-4 Exclusion; and (8) the portion of Exchange Act rule 18a-6(c) relating to Form SBSE and its variations would be subject to the Form SBSE Exclusion.

<sup>147</sup> Substituted compliance with the following requirements of Exchange Act rule 18a-6 would be conditioned on the Covered Entity applying substituted compliance to the linked substantive Exchange Act requirement: (1) Exchange Act rule 18a-6(b)(1)(v) is linked to Exchange Act rule 18a-1 and, therefore, would be subject to the Rule 18a-1 Condition; (2) Exchange Act rules 18a-6(b)(1)(viii) and (b)(2)(v) are linked to Exchange Act rule 18a-7 and, therefore, would be subject to the Rule 18a-7 Condition; (3) Exchange Act rule 18a-6(b)(1)(viii) is linked to Exchange Act

Moreover, there are certain requirements in Exchange Act rule 18a-6 that are not expressly linked to Exchange Act rule 18a-1, but that would be important records in terms of the Commission's ability to examine for compliance with that rule, and the Covered Entity's ability to monitor its net capital position. Therefore, under the proposed Amended Order, substituted compliance for these requirements of Exchange Act rule 18a-6 would be subject to the Rule 18a-1 Condition.<sup>148</sup>

Paragraph (e) of Exchange Act rule 18a-6 sets forth the requirements for preserving records electronically. Paragraph (f) sets forth requirements for when records are prepared or maintained by a third party. The Order makes substituted compliance available for the requirements of paragraphs (e) and (f) of Exchange Act rule 18a-6 if the Covered Entity has a prudential regulator. The proposed Amended Order would extend this treatment to Covered Entities without a prudential regulator.<sup>149</sup>

Paragraph (g) of Exchange Act rule 18a-6 requires an SBS Entity to furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of

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rule 18a-1 and, therefore, would be subject to the Rule 18a-1 Condition; (4) Exchange Act rule 18a-6(b)(1)(ix) is linked to Exchange Act rule 18a-1 and, therefore, would be subject to the Rule 18a-1 Condition; (5) Exchange Act rule 18a-6(b)(1)(x) is linked to Exchange Act rule 18a-1 and, therefore, would be subject to the Rule 18a-1 Condition; (6) Exchange Act rules 18a-6(b)(1)(xii) and (b)(2)(vii) are linked to Exchange Act rule 15Fh-3 and, therefore, would be subject to the Rule 15Fh-3 Condition; (7) Exchange Act rules 18a-6(b)(1)(xii) and (b)(2)(vii) are linked to Exchange Act rule 15Fk-1 and, therefore, would be subject to the Rule 15Fk-1 Condition; (8) Exchange Act rules 18a-6(d)(4) and (d)(5) are linked to Exchange Act rule 15Fi-3 and, therefore, would be subject to the Rule 15Fi-3 Condition; (9) Exchange Act rules 18a-6(d)(4) and (d)(5) are linked to Exchange Act rule 15Fi-4 and, therefore, would be subject to the Rule 15Fi-4 Condition; and (10) Exchange Act rules 18a-6(d)(4) and (d)(5) are linked to Exchange Act rule 15Fi-3 and, therefore, would be subject to the Rule 15Fi-5 Condition.

<sup>148</sup> Substituted compliance with the requirements of Exchange Act rules 18a-6(b)(1)(ii), (b)(1)(iii), (b)(1)(vi), (b)(1)(vii), (d)(2)(i), and (d)(3)(i) would be conditioned on the Covered Entity applying substituted compliance to Exchange Act rule 18a-1.

<sup>149</sup> See paras. (f)(2)(i)(Q) and (R) of the proposed Amended Order.

the SBS Entity that are required to be preserved under Exchange Act rule 18a-6, or any other records of the SBS Entity that are subject to examination or required to be made or maintained pursuant to section 15F of the Exchange Act that are requested by a representative of the Commission. The Order does not make substituted compliance available for the requirements of paragraph (g) of Exchange Act rule 18a-6 because there is no comparable requirement in the EU or Germany to produce these records to a representative of the Commission. The proposed Amended Order similarly would not make substituted compliance available for paragraph (g) of Exchange Act rule 18a-6.

The following table summarizes the Commission’s preliminary positive substituted compliance determinations with respect to requirements of Exchange Act rule 18a-6 by listing in each row: (1) the paragraph of the proposed Amended Order that sets forth the determination; (2) the paragraph(s) of Exchange Act rule 18a-6 to which the determination applies; (3) a brief description of the records required by the paragraph(s); and (4) a brief description of any additional conditions to applying substituted compliance to the requirements, including any partial exclusions because portions of the requirements are linked to substantive Exchange Act requirements for which the proposed Amended Order would not provide substituted compliance.<sup>150</sup>

<b>Exchange Act rule 18a-6 (record preservation)</b>				
<b>Order Paragraph</b>	<b>Rule Paragraph</b>		<b>Rule Description</b>	<b>Conditions and Partial Exclusions</b>
(f)(2)(i)(A)	(a)(1)	(a)(2)	6 year record preservation	N/A
(f)(2)(i)(B)	(b)(1)(i)	(b)(2)(i)	3 year record preservation	N/A

<sup>150</sup> The table does not include the proposed conditions for applying substituted compliance to Exchange Act rule 18a-6; namely that the Covered Entity: (1) must be subject to and complies with the requirements of foreign law; and (2) must promptly furnish to a representative of the Commission upon request an English translation of a record. See para. (f)(8) of the proposed Amended Order (setting forth the English translation requirement).

Exchange Act rule 18a-6 (record preservation)				
Order Paragraph	Rule Paragraph		Rule Description	Conditions and Partial Exclusions
(f)(2)(i)(C)	(b)(1)(ii) (b)(1)(iii)		Bank records, bills	Rule 18a-1 Condition
(f)(2)(i)(D)	(b)(1)(iv)	(b)(2)(ii)	Communications	N/A
(f)(2)(i)(E)	(b)(1)(v)		Trial balances	(1) Rule 18a-1 Condition (2) Rule 18a-2 Exclusion
(f)(2)(i)(F)	(b)(1)(vi)	(b)(2)(iii)	Account documents	Rule 18a-1 Condition for ¶ (b)(1)(vi)
(f)(2)(i)(G)	(b)(1)(vii)	(b)(2)(iv)	Written agreements	Rule 18a-1 Condition for ¶ (b)(1)(vii)
(f)(2)(i)(H)	(b)(1)(viii)		Information supporting financial reports	(1) Rule 18a-7 Condition (2) Rule 18a-4 Exclusion for ¶ (b)(1)(viii)(L) (3) Rule 18a-2 Exclusion for ¶ (b)(1)(viii)(M)
(f)(2)(i)(I)	(b)(1)(ix)		Rule 15c3-4 risk management records	Rule 18a-1 Condition
(f)(2)(i)(J)	(b)(1)(x)		Credit risk determinations	Rule 18a-1 Condition
(f)(2)(i)(K)	(b)(1)(xii)	(b)(2)(vii)	Business conduct standard records	(1) Rule 15Fh-3 Condition (2) Rule 15Fk-1 Condition
(f)(2)(i)(L)	(c)		Corporate documents	Form SBSE Exclusion
(f)(2)(i)(M)	(d)(1)		Associated person's employment application	N/A
(f)(2)(i)(N)	(d)(2)(i)	(d)(2)(ii)	Regulatory authority reports	Rule 18a-1 Condition for ¶ (d)(2)(i)
(f)(2)(i)(O)	(d)(3)(i)	(d)(3)(ii)	Compliance, supervisory, and procedures manuals	Rule 18a-1 Condition for ¶ (d)(3)(i)
(f)(2)(i)(P)	(d)(4) (d)(5)		Portfolio reconciliation	(1) Rule 15Fi-3 Condition (2) Rule 15Fi-4 Condition (3) Rule 15Fi-5 Condition
(f)(2)(i)(Q)	(e)		Electronic storage system	N/A
(f)(2)(i)(R)	(f)		Third-party recordkeeper	N/A

The following table summarizes the Commission's preliminary determinations with respect to requirements of Exchange Act rule 18a-6 for which a positive substituted compliance determination would not be made because they are fully linked to substantive Exchange Act requirements for which the proposed Amended Order would not provide substituted compliance

by listing in each row: (1) the paragraph of the proposed Amended Order that sets forth the determination; (2) the paragraph(s) of Exchange Act rule 18a-6 to which the determination applies; (3) a brief description of the records required by the paragraph(s); and (4) a brief description of why the requirement is excluded from substituted compliance.

<b>Exchange Act rule 18a-6 (preservation)</b>				
<b>Order Paragraph</b>	<b>Rule Paragraph</b>		<b>Rule Description</b>	<b>Exclusion</b>
(f)(2)(ii)	(b)(1)(xi)	(b)(2)(vi)	Regulation SBSR information	Regulation SBSR Exclusion
(f)(2)(i)(H)		(b)(2)(v)	Information supporting financial reports	Rule 18a-4 Exclusion
(f)(2)(ii)	(b)(1)(xiii)	(b)(2)(viii)	Special entity documents	(1) Rule 15Fh-4 Exclusion (2) Rule 15Fh-5 Exclusion

#### 4. Exchange Act Rule 18a-7

Exchange Act rule 18a-7 requires SBS Entities, on a monthly basis (if not prudentially regulated) or on a quarterly basis (if prudentially regulated), to file an unaudited financial and operational report on the FOCUS Report Part II (if not prudentially regulated) or Part IIC (if prudentially regulated). The Commission will use the FOCUS Reports filed by the SBS Entities to both monitor the financial and operational condition of individual SBS Entities and to perform comparisons across SBS Entities. The FOCUS Report Part IIC elicits less information than the FOCUS Report Part II because the Commission does not have responsibility for overseeing the capital and margin requirements applicable to these entities.

The FOCUS Report Parts II and IIC are standardized forms that elicit specific information through numbered line items. This facilitates cross-firm analysis and comprehensive monitoring of all SBS Entities registered with the Commission. Further, the Commission has designated the Financial Industry Regulatory Authority, Inc. (“FINRA”) to receive the FOCUS



Reports from SBS Entities.<sup>151</sup> Broker-dealers registered with the Commission currently file their FOCUS Reports with FINRA through the eFOCUS system it administers. Using FINRA’s eFOCUS system will enable broker-dealers, security-based swap dealers, and major security-based swap participants to file FOCUS Reports on the same platform using the same preexisting templates, software, and procedures.

Paragraph (a)(2) of Exchange Act rule 18a-7 requires SBS Entities with a prudential regulator to file the FOCUS Report Part IIC on a quarterly basis. The Order provides substituted compliance for this requirement subject to the condition that the Covered Entity file with the Commission periodic unaudited financial and operational information in the manner and format specified by the Commission by order or rule (“Manner and Format Condition”) and present the financial information in accordance with GAAP that the firm uses to prepare general purpose publicly available or available to be issued financial statements in Germany (“German GAAP Condition”).<sup>152</sup> The proposed Amended Order would continue to provide Covered Entities with a prudential regulator substituted compliance for paragraph (a)(2) of Exchange Act rule 18a-7, subject to the Manner and Format and German GAAP Conditions.<sup>153</sup> The Commission continues to believe that it would be appropriate to condition substituted compliance with respect to

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<sup>151</sup> See Order Designating Financial Industry Regulatory Authority, Inc., to Receive Form X-17A-5 (FOCUS Report) from Certain Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 88866 (May 14, 2020).

<sup>152</sup> Under the Order, Covered Entities with a prudential regulator must present the information reported in the FOCUS Report in accordance with GAAP that the firm uses to prepare publicly available or available to be issued general purpose financial statements in its home jurisdiction instead of U.S. GAAP if other GAAP, such as International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), is used by the Covered Entity in preparing publicly available or available to be issued general purpose financial statements in Germany.

<sup>153</sup> See para. (f)(3)(i) of the proposed Amended Order.

Exchange Act rule 18a-7 on the Covered Entity filing unaudited financial and operational information in a manner and format that facilitates cross-firm analysis and comprehensive monitoring of all SBS Entities registered with the Commission.<sup>154</sup> For example, the Commission could by order or rule require SBS Entities to file the financial and operational information with FINRA using the FOCUS Report Part II (if not prudentially regulated) or Part IIC (if prudentially regulated) but permit the information input into the form to be the same information the SBS Entity reports to EU and German authorities.

Paragraph (a)(1) of Exchange Act rule 18a-7 requires SBS Entities without a prudential regulator to file the FOCUS Report Part II on a monthly basis. The proposed Amended Order would provide Covered Entities without a prudential regulator substituted compliance for paragraph (a)(1) of Exchange Act rule 18a-7 subject to the Manner and Format and German GAAP conditions.<sup>155</sup> However, there would two additional conditions. First, for the reasons discussed above, the Covered Entity would need to apply substituted compliance for Exchange Act Rule 18a-1 (i.e., substituted compliance would be subject to the Rule 18a-1 Condition).<sup>156</sup> Second, the Covered Entity would need to apply substituted compliance with respect to Exchange Act rule 18a-6(b)(1)(viii) (a record preservation requirement) (“Rule 18a-6(b)(1)(viii) Condition”).<sup>157</sup> This record preservation requirement is directly linked to the financial and operational reporting requirements of Exchange Act rule 18a-7(a)(1).

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<sup>154</sup> In addition to the Order, the Manner and Format condition is included in the French and UK Orders. See French Order, 86 FR at 41651; UK Order, 86 FR at 43361-62.

<sup>155</sup> See para. (f)(3)(i) of the proposed Amended Order.

<sup>156</sup> See para. (f)(3)(i)(C) of the proposed Amended Order. See part VII.B.1, supra (discussing how certain recordkeeping and reporting requirements are expressly linked to or important for examining compliance with Rule 18a-1 condition).

<sup>157</sup> See para. (f)(3)(i)(D) of the proposed Amended Order.

Paragraph (a)(3) of Exchange Act rule 18a-7 requires SBS Entities without a prudential regulator that have been authorized by the Commission to compute net capital under Exchange Act rule 18a-1 using models to file certain monthly or quarterly information related to their use of models.<sup>158</sup> Paragraph (b) of Exchange Act rule 18a-7 requires SBS Entities that are not prudentially regulated to make certain financial information available on their websites.<sup>159</sup> Paragraphs (c), (d), (e), (f), (g), and (h) of Exchange Act rule 18a-7 set forth requirements for SBS Entities that are not prudentially regulated to annually file financial statements and certain reports, as well as reports covering those statements and reports prepared by an independent public accountant.<sup>160</sup> Paragraph (i) of Exchange Act rule 18a-7 requires SBS Entities that do not have a prudential regulator to notify the Commission when they change their fiscal year.<sup>161</sup> Finally, Paragraph (j) of Exchange Act rule 18a-7 sets forth requirements with respect to the reports that must be filed with the Commission under the rule.<sup>162</sup>

The Commission preliminarily is making a positive substituted compliance determination for paragraphs (b) through (j) of Exchange Act rule 18a-7. As discussed below, substituted compliance with respect to these paragraphs of Exchange Act rule 18a-7 would be subject to certain conditions and limitations.

First, certain of the requirements in Exchange Act rule 18a-7 are fully or partially linked to substantive Exchange Act requirements for which a positive substituted compliance determination would be made under the proposed Amended Order. In these cases, substituted

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<sup>158</sup> See 17 CFR 240.18a-7(a)(3).

<sup>159</sup> See 17 CFR 240.18a-7(b).

<sup>160</sup> See 17 CFR 240.18a-7(c) through (h).

<sup>161</sup> See 17 CFR 240.18a-7(i).

<sup>162</sup> See 17 CFR 240.18a-7(i).

compliance with the requirement in Exchange Act rule 18a-7 would be conditioned on the Covered Entity applying substituted compliance to the linked substantive Exchange Act requirement.<sup>163</sup>

Second, under the proposed Amended Order, substituted compliance in connection with the requirement that Covered Entities without a prudential regulator file audited annual reports under Exchange Act rule 18a-7 would be subject to six conditions.<sup>164</sup> The first condition would be that the Covered Entity simultaneously sends a copy of the financial statements the Covered Entity is required to file with EU or German authorities, including a report of an independent public accountant covering the financial statements, to the Commission in the manner specified on the Commission's website ("SEC Filing Condition"). Because EU and German laws would not otherwise require the financial statements and report of the independent public accountant covering the financial statements to be filed with the Commission, the purpose of this condition would be to provide the Commission with the financial statements and report to more effectively supervise and monitor Covered Entities.

The second condition would be that the Covered Entity include with the transmission of the annual financial statements and report the contact information of an individual who can provide further information about the financial statements and reports ("Contact Information

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<sup>163</sup> Substituted compliance with the following requirements of Exchange Act rule 18a-7 would be conditioned on the Covered Entity applying substituted compliance to the linked substantive Exchange Act requirement: (1) Exchange Act rule 18a-7(a)(1) is linked to Exchange Act rules 18a-1 and 18a-6(b)(1)(viii) and, therefore, would be subject to the Rule 18a-1 Condition and the Rule 18a-6(b)(1)(viii) Condition; (2) Exchange Act rule 18a-7(a)(3) is linked to Exchange Act rule 18a-1 and, therefore, would be subject to the Rule 18a-1 Condition; (3) Exchange Act rule 18a-7(b) is linked to Exchange Act rule 18a-6(b)(1)(viii) and, therefore, would be subject to the Rule 18a-6(b)(1)(viii) Condition; and (4) Exchange Act rules 18a-7(c), (d), (e), (f), (g) and (h) taken as a whole are linked to Exchange Act rules 18a-1 and 18a-6(b)(1)(viii) and, therefore, would be subject to the Rule 18a-1 Condition and the Rule 18a-6(b)(1)(viii) Condition.

<sup>164</sup> See para. (f)(3)(iv)(B) to the proposed Amended Order.

Condition”). This would assist the Commission staff in promptly contacting an individual at the Covered Entity who can respond to questions that information on the financial statements or report may raise about the Covered Entity’s financial or operational condition.

The third condition would be that the Covered Entity includes with the transmission the report of an independent public accountant required by Exchange Act rule 18a-7(c)(1)(i)(C) covering the annual financial statements if EU and German laws do not require the Covered Entity to engage an independent public accountant to prepare a report covering the annual financial statements (“Accountant’s Report Condition”). The third condition further would provide that the report of the independent public accountant may be prepared in accordance with generally accepted auditing standards (“GAAS”) in Germany that are used to perform audit and attestation services and the accountant complies with German independence requirements. According to the BaFin Application, German laws only require certain investment firms (depending on their size) to have their financial statements audited, so this condition would be designed to ensure that all SBS Entities subject to the requirement in rule 18a-7 to file audited annual reports are required to have their financial statements audited.

The fourth condition would be that a Covered Entity that is a security-based swap dealer would need to file the reports required by Exchange Act rule 18a-7(c)(1)(i)(B) and (C) addressing the statements identified in Exchange Act rule 18a-7(c)(3) or (c)(4), as applicable, that relate to Exchange Act rule 18a-4 (“Rule 18a-4 Limited Exclusion”).<sup>165</sup> These reports are designed to provide the Commission with information about an SBS Entity’s compliance with

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<sup>165</sup> The Commission views this as a limited exclusion from the availability of substituted compliance for these requirements because the proposed Amended Order would permit these reports relating Exchange Act rule 18a-4 to be included with the German regulatory reports the Covered Entities will file with the Commission and because the reports could be prepared in accordance with German GAAS (as discussed below).

Rule 18a-4. Substituted compliance is not available for Exchange Act rule 18a-4 and, therefore, this condition is designed to provide the Commission with similar compliance information.

Under this condition, Covered Entities would need to file a limited compliance report that includes the statements relating to Rule 18a-4<sup>166</sup> or an exemption report if the Covered Entity claims an exemption from Rule 18a-4. The Covered Entity also would need to file the report of an independent public accountant covering the limited compliance report or exemption report. The fourth condition further would provide that the report of the independent public accountant may be prepared in accordance with GAAS in Germany that are used to perform audit and attestation services and the accountant complies with German independence requirements.

The fifth condition would be that a Covered Entity that is a major security-based swap participant would need to file the supporting schedules required by Exchange Act rule 18a-7(c)(1)(i)(A) and (C) addressing the statements identified in Exchange Act rules 18a-7(c)(2)(ii) and (iii) that relate to Exchange Act rule 18a-2 for which the proposed Amended Order would not provide substituted compliance. These supporting schedules are the Computation of Tangible Net Worth.

The sixth condition would be that a Covered Entity that is a security-based swap dealer would need to file the supporting schedules required by Exchange Act rule 18a-7(c)(1)(i)(A) and (C) addressing the statements identified in Exchange Act rules 18a-7(c)(2)(ii) and (iii) that relate to Exchange Act rule 18a-4 and 18a-4a if the Covered Entity is not exempt from Exchange Act rule 18a-4 (i.e., the Rule 18a-4 Limited Exclusion). These supporting schedules are the

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<sup>166</sup> The limited compliance report would not need to address Exchange Act rule 18a-9 if the Covered Entity is applying substituted compliance to this requirement. Further, as discussed above, substituted compliance with paras. (c) through (h) of Exchange Act rule 18a-7 is conditioned on the Covered Entity applying substituted compliance to Exchange Act rule 18a-1. Therefore, the Covered Entity would not need to address that rule in the compliance report. Finally, the Covered Entity would not need to address an account statement rule of a self-regulatory organization.

Computation for Determination of Security-Based Swap Customer Reserve Requirements and the Information Relating to the Possession or Control Requirements for Security-Based Swap Customers, which are designed to provide the Commission with information about an SBS Entity's compliance with Rule 18a-4. Substituted compliance for Exchange Act rule 18a-4 is not available.

The following table summarizes the Commission's proposed preliminary positive substituted compliance determinations with respect to requirements of Exchange Act rule 18a-7 by listing in each row: (1) the paragraph of the proposed Amended Order that sets forth the determination; (2) the paragraph(s) of Exchange Act rule 18a-7 to which the determination applies; (3) a brief description of the records required by the paragraph(s); and (4) a brief description of any additional conditions to applying substituted compliance to the requirements, including any partial exclusions because portions of the requirements are linked to substantive Exchange Act requirements for which the proposed Amended Order would not provide substituted compliance.<sup>167</sup>

Exchange Act rule 18a-7 (reporting)				
Order Paragraph	Rule Paragraph		Rule Description	Conditions and Partial Exclusions
(f)(3)(i)	(a)(1)	(a)(2)	File FOCUS Reports	(1) Manner and Format Condition (2) German GAAP Condition (3) Rule 18a-1 Condition for ¶ (a)(1) (4) Rule 18a-6(b)(1)(viii) Condition for ¶ (a)(1)
(f)(3)(ii)	(a)(3)		Information related to capital models	(1) Rule 18a-1 Condition
(f)(3)(iii)	(b)		Publish certain financial information	(1) Rule 18a-6(b)(1)(viii) Condition

<sup>167</sup> The chart below does not include the proposed conditions for applying substituted compliance to Exchange Act rule 18a-7; namely that the Covered Entity: (1) must be subject to and comply with specified requirements of foreign law; and (2) must promptly furnish to a representative of the Commission upon request an English translation of a report. See para. (f)(8) of the proposed Amended Order (setting forth the English translation requirement).

Exchange Act rule 18a-7 (reporting)			
Order Paragraph	Rule Paragraph	Rule Description	Conditions and Partial Exclusions
(f)(3)(iv)	(c) (d) (e) (f) (g) (h)	File annual audited reports	(1) SEC Filing Condition (2) Contact Information Condition (3) Accountant's Report Condition (4) Rule 18a-4 Limited Exclusion (5) Supporting Schedules Condition (6) Rule 18a-1 Condition (7) Rule 18a-6(b)(1)(viii) Condition

## 5. Exchange Act Rule 18a-8

Exchange Act rule 18a-8 requires SBS Entities to send notifications to the Commission if certain adverse events occur.<sup>168</sup> The Order provides substituted compliance for the requirements of Exchange Act rule 18a-8 applicable to SBS Entities with a prudential regulator (subject to conditions and limitations). In particular, the requirements of: (1) paragraph (c) of Exchange Act rule 18a-8 that an SBS Entity that is a security-based swap dealer and that files a notice of adjustment to its reported capital category with a U.S. prudential regulator must transmit a copy of the notice to the Commission; (2) paragraph (d) of the rule that an SBS Entity provide notification to the Commission if it fails to make and keep current books and records under Exchange Act rule 18a-5 and to transmit a subsequent report on steps being taken to correct the situation; (3) and paragraph (h) of the rule setting forth how to make the notifications required by Exchange Act 18a-8.

Under the Order, substituted compliance in connection with the notification requirements of Exchange Act rule 18a-8 are subject to the conditions that the Covered Entity: (1) simultaneously sends a copy of any notice required to be sent by EU or German notification laws to the Commission in the manner specified on the Commission's website (i.e., the "SEC Filing Condition"); and (2) includes with the transmission the contact information of an individual who

<sup>168</sup> See 17 CFR 240.18a-8.



can provide further information about the matter that is the subject of the notice (i.e., the "Contact Information Condition"). The purpose of these conditions is to alert the Commission to financial or operational problems that could adversely affect the firm – the objective of Exchange Act rule 18a-8. In addition, the Order does not provide substituted compliance for paragraph (g) of Exchange Act rule 18a-8 that an SBS Entity that is a security-based swap dealer provide notification if it fails to make a required deposit into its special reserve account for the exclusive benefit of security-based swap customers under Exchange Act rule 18a-4. Substituted compliance is not available for Exchange Act rule 18a-4.

The proposed Amended Order would continue to provide Covered Entities with a prudential regulator substituted compliance for the notification requirements of Exchange Act rule 18a-8 discussed above subject to the conditions and limitations. However, the substituted compliance determinations would be made on a more granular basis. Further, the proposed Amended Order would provide Covered Entities without a prudential regulator substituted compliance for these notification requirements (also on a granular basis), subject to the SEC Filing and Contact Information Conditions. The proposed Amended Order also would apply the limitation with respect to the notification requirements linked to Exchange Act rule 18a-4 to Covered Entities without a prudential regulator.

Exchange Act rule 18a-8 has notification requirements that apply exclusively to Covered Entities without a prudential regulator. In particular, paragraphs (a)(1)(i), (a)(1)(ii), (b)(1), (b)(2), and (b)(4) of Exchange Act rule 18a-8 require an SBS Entity that is a security-based swap dealer and that does not have a prudential regulator to provide notifications related to the capital requirements of Exchange Act rule 18a-1. Paragraphs (a)(2) and (b)(3) of Exchange Act rule 18a-8 require an SBS Entity that is a major security-based swap participant and that does not

have a prudential regulator to provide notifications related to the capital requirements of Exchange Act rule 18a-2. Paragraph (e) of Exchange Act rule 18a-8, in pertinent part, requires an SBS Entity that is a security-based swap dealer and that does not have a prudential regulator to provide notification if it has a material weakness under Exchange Act rule 18a-7 and to transmit a subsequent report on the steps being taken to correct the situation.

The Commission is preliminarily making a positive substituted compliance determination for a number of the notification requirements set forth in these paragraphs, subject to the SEC Filing and Contact Information Conditions. However, certain of these requirements are linked to substantive Exchange Act requirements for which the proposed Amended Order would not provide substituted compliance. In these cases, a positive substituted compliance determination would not be made for the linked requirement in Exchange Act rule 18a-8 or the portion of the requirement in Exchange Act rule 18a-8 that is linked to the substantive Exchange Act requirement.<sup>169</sup>

In addition, certain of the requirements in Exchange Act rule 18a-8 are fully or partially linked to substantive Exchange Act requirements where a positive substituted compliance determination would be made under the proposed Amended Order. In these cases, substituted

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<sup>169</sup> A positive substituted compliance determination would not be made for the following requirements of Exchange Act rule 18a-8 because they are linked to a substantive Exchange Act requirement for which a positive substituted compliance determination is not being made: (1) Exchange Act rules 18a-8(a)(3) and (b)(3) are fully linked to Exchange Act rule 18a-2 and, therefore, would be subject to the Rule 18a-2 Exclusion; (2) the portion of Exchange Act rule 18a-8(e) that relates to Exchange Act rule 18a-2 would be subject to the Rule 18a-2 Exclusion; (3) the portion of Exchange Act rule 18a-8(e) that relates to Exchange Act rule 18a-4 would be subject to the Rule 18a-4 Exclusion; and (4) Exchange Act rule 18a-8(g) is fully linked to Exchange act rule 18a-4 and, therefore, would be subject to the Rule 18a-4 Exclusion.

compliance with the requirement in Exchange Act rule 18a-8 would be conditioned on the SBS Entity applying substituted compliance to the linked substantive Exchange Act requirement.<sup>170</sup>

The following table summarizes the Commission’s proposed preliminary positive substituted compliance determinations with respect to requirements of Exchange Act rule 18a-8 by listing in each row: (1) the paragraph of the proposed Amended Order that sets forth the determination; (2) the paragraph(s) of Exchange Act rule 18a-8 to which the determination applies; (3) a brief description of the notifications required by the paragraph(s); and (4) a brief description of any additional conditions to applying substituted compliance to the requirements, including any partial exclusions because portions of the requirements are linked to substantive Exchange Act requirements for which the proposed Amended Order would not provide substituted compliance.<sup>171</sup>

<b>Exchange Act rule 18a-8 (notification)</b>				
<b>Order Paragraph</b>	<b>Rule Paragraph</b>		<b>Rule Description</b>	<b>Conditions and Partial Exclusions</b>
(f)(4)(i)(A)	(a)(1)(i)		Capital notices	(1) Rule 18a-1 Condition (2) SEC Filing Condition (3) Contact Information Condition
	(a)(1)(ii)			
	(b)(1)			
	(b)(2)			
	(b)(4)			

<sup>170</sup> Substituted compliance with the following requirements of Exchange Act rule 18a-8 would be conditioned on the Covered Entity applying substituted compliance to the linked substantive Exchange Act requirement: (1) Exchange Act rules 18a-8(a)(1)(i) and (ii), (b)(1), (b)(2), and (b)(4) are linked to Exchange Act rule 18a-1 and, therefore, would be subject to the Rule 18a-1 Condition; and (2) Exchange Act rule 18a-8(d) is linked to Exchange Act rule 18a-5 and, therefore, would be subject to the Rule 18a-5 Condition with respect to any category of records required to be made and kept current by that rule. With respect to Exchange Act rule 18a-8(d), if the Covered Entity does not apply substituted compliance with respect to a category of record required to be made and kept current by Exchange Act rule 18a-5, the Covered Entity would need to provide the notification required by Exchange Act rule 18a-8(d) if it fails to make and keep current that category of record.

<sup>171</sup> The chart below does not include the proposed conditions for applying substituted compliance to Exchange Act rule 18a-8; namely that the Covered Entity: (1) must be subject to and comply with specified requirements of foreign law; and (2) must promptly furnish to a representative of the Commission upon request an English translation of a notification. See para. (f)(8) of the proposed Amended Order (setting forth the English translation requirement).

Exchange Act rule 18a-8 (notification)				
Order Paragraph	Rule Paragraph		Rule Description	Conditions and Partial Exclusions
(f)(4)(i)(B)	(c)		Prudential regulator capital category adjustment notices	(1) SEC Filing Condition (2) Contact Information Condition
(f)(4)(i)(C)	(d)		Books and records notices	(1) Rule 18a-5 Condition (2) SEC Filing Condition (3) Contact Information Condition
(f)(4)(i)(D)	(e)		Material weakness notices	(1) Rule 18a-1 Condition (2) Rule 18a-2 Exclusion (3) Rule 18a-4 Limited Exclusion (4) SEC Filing Condition (5) Contact Information Condition

The following table summarizes the Commission's preliminary determinations with respect to requirements of Exchange Act rule 18a-8 for which a positive substituted compliance determination would not be made because they are fully linked to substantive Exchange Act requirements for which the proposed Amended Order would not provide substituted compliance by listing in each row: (1) the paragraph of the proposed Amended Order that sets forth the determination; (2) the paragraph(s) of Exchange Act rule 18a-8 to which the determination applies; (3) a brief description of the records required by the paragraph(s); and (4) the exclusion from substituted compliance.

Exchange Act rule 18a-8 (notification)				
Order Paragraph	Rule Paragraph		Rule Description	Exclusion
(f)(4)(ii)(B)	(a)(2)	(b)(3)	MSBSP capital notices	Rule 18a-2 Exclusion
(f)(4)(ii)(C)	(g)		Reserve account notices	Rule 18a-4 Exclusion

#### 6. Exchange Act Rule 18a-9

Exchange Act rule 18a-9 requires SBS Entities that are security-based swap dealers without a prudential regulator to examine and count the securities they physically hold, account for the securities that are subject to their control or direction but are not in their physical

possession, verify the locations of securities under certain circumstances, and compare the results of the count and verification with their records.<sup>172</sup> The Commission preliminarily believes EU and German laws produce a comparable result in terms of securities count requirements.<sup>173</sup> Accordingly, the Commission preliminarily is making a positive substituted compliance determination for this rule.<sup>174</sup>

#### 7. Exchange Act Section 15F(g)

Exchange Act Section 15F(g) requires SBS Entities to maintain daily trading records.<sup>175</sup> The Commission preliminarily believes EU and German laws produce a comparable result in terms of daily trading recordkeeping requirements.<sup>176</sup> Accordingly, the Commission preliminarily is making a positive substituted compliance determination for the self-executing requirements in this statute.<sup>177</sup>

#### 8. Examination and production of records

The Order does not extend to, and Covered Entities remain subject to, the requirement of Exchange Act section 15F(f) to keep books and records open to inspection by any representative of the Commission and the requirement of Exchange Act rule 18a-6(g) to furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of the Covered Entity that are required to be preserved under Exchange Act rule 18a-6, or any other records of the Covered Entity that are subject to examination or required to be made or

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<sup>172</sup> See 17 CFR 240.18a-9.

<sup>173</sup> See EMIR article 11(1)(b); EMIR RTS articles 12 and 13; WpHG section 84; HGB sections 316 and 325; and WpHG section 89 (1) sentence 1 no. 1.

<sup>174</sup> See para. (f)(5) to the proposed Amended Order.

<sup>175</sup> See 15 USC 78o-10(g).

<sup>176</sup> See WpHG section 83 para. 1; and MiFID Org Reg article 21(1)(f), 21(4), and 72(1)

<sup>177</sup> See para. (f)(6) to the proposed Amended Order.

maintained pursuant to Exchange Act section 15F that are requested by a representative of the Commission.<sup>178</sup> The proposed Amended Order similarly would not extend substituted compliance to these inspection and production requirements.<sup>179</sup>

Consequently, every Covered Entity registered with the Commission, whether complying directly with Exchange Act requirements or relying on substituted compliance as a means of complying with the Exchange Act, is required to satisfy the inspection and production requirements imposed on such entities under the Exchange Act. Covered Entities may make, keep, and preserve records, subject to the conditions described above, in a manner prescribed by applicable EU and German requirements. BaFin has provided the Commission with adequate assurances that no law or policy would impede the ability of any entity that is directly supervised by the authority and that may register with the Commission to provide prompt access to the Commission to such entity's books and records or to submit to onsite inspection or examination by the Commission. Consistent with those assurances and the requirements that apply to all Covered Entities under the Exchange Act, Covered Entities operating under the proposed Amended Order would need to keep books and records open to inspection by any representative of the Commission and to furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of the firm that these entities are required to preserve under Exchange Act rule 18a-6 (which would include records for which a positive substituted compliance determination is being made with respect to Exchange Act rule 18a-6 under the Order), or any other records of the firm that are subject to examination or required to

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<sup>178</sup> See Exchange Act section 15F(f); Exchange Act rule 18a-6(g). The French and UK Orders do not extend substituted compliance to these requirements. See French Order, 86 FR at 41650; UK Order, 86 FR at 43361.

<sup>179</sup> See para. (f)(7) to the proposed Amended Order.

be made or maintained pursuant to Exchange Act section 15F that are requested by a representative of the Commission.

#### 9. English translations

The proposed Amended Order provides that to the extent documents are not prepared in the English language, Covered Entities would need to furnish to a representative of the Commission upon request an English translation of any record, report, or notification of the Covered Entity that is required to be made, preserved, filed, or subject to examination pursuant to Exchange Act section 15F or the German Order.<sup>180</sup> This proposed condition would be designed to address difficulties that Commission examinations staff would have examining Covered Entities that furnish documents in a foreign language. The English translations would need to be provided promptly. This condition is included in the French and UK Orders.<sup>181</sup>

### **VIII. Additional Considerations Regarding Supervisory and Enforcement Effectiveness Related to Capital and Margin**

#### A. General Considerations

Exchange Act rule 3a71-6 provides that the Commission's assessment of the comparability of the requirements of the foreign financial regulatory system take into account "the effectiveness of the supervisory program administered, and the enforcement authority exercised" by the foreign financial regulatory authority. This prerequisite accounts for the understanding that substituted compliance determinations should reflect the reality of the foreign regulatory framework, in that rules that appear high-quality on paper nonetheless should not form the basis for substituted compliance if – in practice – market participants are permitted to

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<sup>180</sup> See para. (f)(8) to the proposed Amended Order.

<sup>181</sup> See French Order, 86 FR at 41651; UK Order, 86 FR at 43361.

fall short of their regulatory obligations. This prerequisite, however, also recognizes that differences among the supervisory and enforcement regimes should not be assumed to reflect flaws in one regime or another.<sup>182</sup>

In the substituted compliance Order for Germany the Commission concluded that “the relevant supervisory and enforcement considerations in Germany are consistent with substituted compliance.”<sup>183</sup> In its amended application, BaFin provided the Commission with additional information on the supervision and enforcement framework for compliance with capital and margin requirements applicable to significant credit institutions. For purposes of the supervision of capital and margin by Germany, the Commission preliminary believes that the relevant supervisory and enforcement considerations for capital and margin in Germany are consistent with substituted compliance.

In preliminarily concluding that the relevant supervisory and enforcement considerations are consistent with substituted compliance, the Commission has considered the supervision and enforcement framework described in the Order as well as the following factors:<sup>184</sup>

B. Supervisory and Enforcement framework in Germany

The ECB, through its single supervisory mechanism (“SSM”) and executed by joint supervisory teams (“JSTs”), supervises firms for compliance with the CRD and CRR, including all capital requirements. The JSTs comprise of ECB staff, BaFin staff, and staff from other

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<sup>182</sup> See generally Business Conduct Adopting Release, 81 FR at 30079.

<sup>183</sup> Order, 85 FR at 84697.

<sup>184</sup> The factors described in this section are in addition to the factors described in the German Substituted Compliance Notice and Proposed Order. See Exchange Act Release No. 90378 (Nov. 9, 2020), 85 FR 72726, 72739-40 (Nov. 13, 2020) (“German Substituted Compliance Notice and Proposed Order”).



countries in the EU where the significant institution has a subsidiary or branch.<sup>185</sup> For each firm, the JST conducts a Supervisory Review and Evaluation Process (“SREP”), which measures the risks for each bank. The SREP shows where a firm stands in terms of capital requirements and the way it handles risks. To develop the SREP, supervisors review the sustainability of each firm’s business model, governance and risk management by the firm, capital risks (credit, market, operational, rate in the banking book and equity risks), and liquidity and funding risks. Once the SREP is developed, the firm will receive a letter setting forth specific measures that must be implemented the following year based on the firm’s individual profile. For example, the SREP may ask the firm to hold additional capital or set forth qualitative requirements related to the firm’s governance structure or management. After these supervisory measures are imposed, the JST will monitor the credit institutions to ensure that it establishes compliance with the regulatory framework and supervisory measures taken. If a credit institution does not comply with such measures, additional actions are considered. Available actions for the JST range from informal communication with the supervised entity to enforcement measures or sanctions.

Misconduct detected by the JSTs is addressed primarily by the ECB. The ECB has the power to enforce violations and to impose fines on supervised entities for breaches of directly applicable European Union law. The ECB can also ask national competent authorities (such as BaFin) to open proceedings that may lead to the imposition of certain pecuniary and non-pecuniary penalties.

## **IX. Request for Comment**

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<sup>185</sup> Information on the ECB supervision was obtained from the SSM Supervisory Manual, March 2018, *available at*: <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.supervisorymanual201803.en.pdf?42da4200dd38971a82c2d15b9ebc0e65>.

A. Nonbank capital and margin

1. Capital

The Commission further requests comment regarding the comparability analysis of EU and German capital requirements with Exchange Act capital requirements for security-based swap dealers without a prudential regulator. Commenters particularly are invited to address the basis for substituted compliance in connection with those requirements, and the proposed conditions and limitations connected to substituted compliance for those requirements. Does EU and German law taken as a whole produce regulatory outcomes that are comparable to those of Exchange Act rule 18a-1? Are there any additional conditions that should be applied to substituted compliance for these capital requirements to promote comparable regulatory outcomes, as a supplement or alternative to those in the proposed Amended Order?

The Commission requests comment on the proposed capital condition that is designed to bridge the gap between the Basel capital standard and the net liquid assets test imposed by Exchange Act rule 18a-1. Under this condition, a Covered Entity would need to: (1) maintain liquid assets (as defined in the proposed condition) that have an aggregate market value that exceeds the amount of the Covered Entity's total liabilities by at least \$100 million before applying the deduction specified in the proposed condition, and by at least \$20 million after applying the deduction specified in the proposed condition; (2) make and preserve for three years a quarterly record that: (a) identifies and values the liquid assets maintained as defined in the proposed condition, (b) compares the amount of the aggregate value the liquid assets maintained pursuant to the proposed condition to the amount of the Covered Entity's total liabilities and shows the amount of the difference between the two amounts ("the excess liquid assets amount"), and (c) shows the amount of the deduction specified in the proposed condition and the

amount that deduction reduces the excess liquid assets amount; (3) notify the Commission in writing within 24 hours in the manner specified on the Commission's website if the Covered Entity fails to meet the requirements of the proposed condition and include in the notice the contact information of an individual who can provide further information about the failure to meet the requirements; and (4) include its most recent statement of financial condition filed with its local supervisor (whether audited or unaudited) with its initial written notice to the Commission of its intent to rely on substituted compliance. The Commission requests comment on each prong of this condition. Please identify any regulatory or operational issues in connection with adhering to each prong of this condition. The Commission requests comment on how this proposed condition would compare to the liquidity requirements a Covered Entity is subject to under the Basel capital standard.

For the purposes of this additional capital condition, "liquid assets" would be defined as: (1) cash and cash equivalents; (2) collateralized agreements; (3) customer and other trading related receivables; (4) trading and financial assets; and (5) initial margin posted by the Covered Entity to a counterparty or third-party, subject to certain conditions. Are these definitions of the categories of liquid assets sufficiently clear? For example, should the definitions provide more detail about the types of assets that could be included within a category? If so, please explain. Should the condition use different definitions? If so, please explain why and suggest an alternative definition.

For the purposes of this additional capital condition, the deduction (haircut) would be determined by dividing the amount of the Covered Entity's risk-weighted assets by 12.5 (i.e., the reciprocal of 8%). Is this an appropriate method of calculating the deduction? If not, explain why and suggest an alternative method. Would this deduction be comparable to the haircuts

under Exchange Act rule 18a-1? If not, explain why. More generally, is the term “risk-weighted assets” understood by market participants? If not, please explain why.

Under this proposed capital condition, the Covered Entity would be required to maintain an excess of liquid assets over total liabilities that equals or exceeds \$100 million before the deduction (derived from the firm’s risk-weighted assets) and \$20 million after the deduction. Is “total liabilities” an appropriate metric for this condition? The \$100 million requirement is modeled on the minimum tentative net capital requirement of Exchange Act rule 18a-1 and \$20 million requirement is modeled on the minimum fixed-dollar net capital requirement of the rule. Are these appropriate requirements for the proposed condition? If not, explain why and suggest alternative requirements. For example, should the amount before applying the proposed deduction be \$50, \$75, \$125, or \$150 million or some other amount, or should the amount after the proposed deductions be \$10, \$30, or \$50 million or some other amount? If so, explain why.

The Commission requests comment on the proposed capital condition that would require the Covered Entity to apply substituted compliance with respect to Exchange Act rules 18a-5(a)(9) (a record making requirement), 18a-6(b)(1)(x) (a record preservation requirement), and 18a-8(a)(1)(i), (a)(1)(ii), (b)(1), (b)(2), and (b)(4) (notification requirements). Is this proposed capital condition appropriate? If not, explain why. Would the proposed capital condition provide clarity as to the Covered Entity’s obligations under these recordkeeping and notification requirements when applying substituted compliance with respect to Exchange Act rule 18a-3? If not, please explain why.

The Commission requests comment on the potential benefits and costs of the potential capital conditions. Would the conditions promote comparable regulatory outcomes between the capital requirements applied to Covered Entities in Germany and capital requirements under

Exchange Act rule 18a-1? If so, explain why. If not, explain why not. The Commission is mindful that compliance with these capital conditions would require Covered Entities applying substituted compliance to Exchange Act rule 18a-1 to supplement their existing capital calculations and practices, as well as to incur additional time and cost burdens to implement the potential conditions and integrate them into existing business operations. The Commission requests comment and supporting data on these potential time and cost burdens, including quantitative information about the amount of the burdens. The Commission also requests comment on any potential operational or regulatory issues or burdens associated with adhering to the proposed capital conditions.

The Commission requests comment on the potential impacts the capital conditions would have on competition. For example, how would they impact competition between Covered Entities applying substituted compliance with respect to Exchange Act rule 18a-1 and SBS Entities that will comply with Exchange Act rule 18a-1? Would the conditions eliminate or mitigate potential competitive advantages that Covered Entities adhering to the Basel capital standard might have over SBS Entities adhering to the more stringent net liquid assets test standard of Exchange Act rule 18a-1? Alternatively, would the conditions create competitive disadvantages for Covered Entities applying substituted compliance with respect to Exchange Act rule 18a-1 compared to SBS Entities complying with Exchange Act rule 18a-1? Please describe the competitive advantages or disadvantages and explain their impact.

Please identify and describe any potential impacts the proposed capital conditions would have on the way Covered Entities currently conduct their business.

The first proposed capital condition for substituted compliance with Exchange Act rule 18a-1 requires the Covered Entity to be subject to and comply with specific EU and German

capital and liquidity requirements. Under Articles 7 and 8 of the CRR, supervisory authorities can grant a Covered Entity a waiver from these EU and German capital and/or liquidity requirements if its parent is subject to them. The Bafin's Amended Application requests substituted compliance for Covered Entities operating pursuant to these waivers. The proposed Amended Order requires the Covered Entity (i.e., the registrant itself) to be subject to the specified EU and German capital and liquidity requirements. Accordingly, it would not provide substituted compliance for Exchange Act rule 18a-1 to a Covered Entity operating pursuant to these waivers.

However, the Commission requests comment on whether a positive substituted compliance determination (subject to conditions and limitations) could be made with respect to a Covered Entity operating pursuant to a waiver from compliance with the Basel capital and liquidity requirements when its immediate holding company is subject to those requirements. Are there additional conditions that could be imposed on a Covered Entity operating pursuant to these waivers that could produce a comparable regulatory outcome to Exchange Act rule 18a-1? If so, describe the conditions and explain how they would produce a comparable regulatory outcome. For example, should the Commission consider imposing additional conditions on either the Covered Entity and/or its immediate holding company? In this regard, should the Covered Entity *and* its immediate holding company be subject to the proposed four-pronged capital condition that is designed to bridge the gap between the Basel capital standard and the net liquid assets test of Exchange Act rule 18a-1? Further, should substituted compliance be conditioned on the Covered Entity maintaining a pool of liquid and unencumbered assets to meet potential cash outflows over a 30-day (or longer or shorter) stress period? Should the pool of unencumbered liquid assets be sized based on an alternative metric? Should the Commission

further condition substituted compliance in this fact pattern on the Covered Entity complying with paragraph (f) under Exchange Act rule 18a-4 (i.e., the exemption from segregation requirements) in order to limit its business activities? Are there other limits that should be placed on the Covered Entity's activities that would mitigate the risk of the firm not being directly subject to EU and German capital and liquidity requirements? If so, please describe them.

The Commission further requests comment on whether any investment firms that may be relying on the Commission's proposed substituted compliance determination with respect to Exchange Act rule 18a-1 would potentially be covered under the new prudential rules for investment firms in the EU and Germany. If so, should the Commission make a positive substituted compliance determination with respect to these capital requirements? If so, explain how they are comparable to the capital requirements of Exchange Act rule 18a-1.

Commenters also are invited to address any differences between German requirements and the French and UK requirements that formed the basis for the Commission's conditional grants of substituted compliance for capital in the French and UK Orders.<sup>186</sup> Are there reasons to take a different approach with respect to substituted compliance in a final German amended order than was taken in the French and UK Orders with respect to capital? If so, identify the differences and explain why they should result in a different approach.

The Commission further requests comment on whether there would be major security-based swap participants without a prudential regulator in Germany that would seek substituted compliance with respect to Exchange Act rule 18a-2.

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<sup>186</sup> See French Order, 86 FR at 41658-59; UK Order, 86 FR at 43371-71.

## 2. Margin

The Commission further requests comment regarding the Commission's preliminary view that the EU and German margin requirements are comparable to Exchange Act rule 18a-3, subject to additional conditions to address differences in counterparty exceptions. Commenters particularly are invited to address the basis for substituted compliance in connection with those requirements. Does EU and German law taken as a whole produce regulatory outcomes that are comparable to those of Exchange Act rule 18a-3? Are there any additional conditions that should be applied to substituted compliance for these margin requirements to promote comparable regulatory outcomes, as a supplement or alternative to those in the proposed Amended Order?

The Commission further requests comment on whether the haircuts required under the EMIR Margin RTS are comparable to the collateral haircuts required under paragraph (c)(3) of Exchange Act rule 18a-3. The Commission also requests comment on whether the standardized grid for computing initial margin under the EMIR Margin RTS is comparable to the standardized approach for computing initial margin under paragraph (d)(1) of Exchange Act rule 18a-3.

The Commission requests comment and supporting data on the proposed margin conditions that are designed to address differences in the counterparty exceptions between Exchange Act rule 18a-3 and German and EU margin requirements. The first proposed additional margin condition would require a Covered Entity to collect variation margin, as defined in the EMIR Margin RTS, from a counterparty with respect to a transaction in a non-cleared security-based swap, unless the counterparty would qualify for an exception under Exchange Act rule 18a-3 from the requirement to deliver variation margin to the Covered Entity. The second proposed additional margin condition would require a Covered Entity to collect



initial margin, as defined in the EMIR Margin RTS, from a counterparty with respect to a transaction in a non-cleared security-based swap, unless the counterparty would qualify for an exception under Exchange Act rule 18a-3 from the requirement to deliver initial margin to the Covered Entity. Do these proposed margin conditions accomplish the goal of closing the gap between the counterparty exceptions of Exchange Act rule 18a-3 and the EU and German margin requirements? If so, please explain. If not, please explain why. Would the proposed margin conditions impact any particular type of counterparty more than another? If so, please explain. Does the fact that the EU and German margin requirements have a final phase-in date for implementation of initial margin requirements of September 1, 2022 impact the ability of Covered Entities to implement the proposed margin conditions? If so, please explain.

The Commission also requests comment on the proposed margin condition that a Covered Entity apply substituted compliance for the requirements of Exchange Act rule 18a-5(a)(12) (a record making requirement). Is this proposed margin condition appropriate? If not, explain why. Would the proposed margin condition provide clarity as to the Covered Entity's obligations under this record making requirement when applying substituted compliance with respect to Exchange Act rule 18a-3? If not, please explain why.

The Commission requests comment on the potential benefits and costs of the potential margin conditions. Would the conditions promote comparable regulatory outcomes between the margin requirements applied to Covered Entities in the EU and Germany and the margin requirements of Exchange Act rule 18a-3? If so, explain why. If not, explain why not. The Commission is mindful that compliance with the proposed margin conditions would require Covered Entities applying substituted compliance to Exchange Act rule 18a-3 to supplement their existing margin processes and documentation, as well as to incur additional time and cost

burdens to implement the potential margin conditions and integrate them into existing business operations. The Commission requests comment and supporting data on these potential time and cost burdens, including quantitative information about the amount of the burdens. The Commission also requests comment on any potential operational or regulatory issues or burdens associated with adhering to the proposed margin conditions.

The Commission requests comment on the potential impacts the margin conditions would have on competition. For example, how would they impact competition between Covered Entities applying substituted compliance with respect to Exchange Act rule 18a-3 and SBS Entities that will comply with Exchange Act rule 18a-3? Would the conditions eliminate or mitigate potential competitive advantages that Covered Entities complying with EU and German margin requirements might have over SBS Entities complying with the margin requirements of Exchange Act rule 18a-3? Alternatively, would the proposed margin conditions create competitive disadvantages for Covered Entities applying substituted compliance with respect to Exchange Act rule 18a-3 compared to SBS Entities complying with Exchange Act rule 18a-3? Please describe the competitive advantages or disadvantages and explain their impact.

Please identify and describe any potential impacts on the way Covered Entities currently conduct their business with respect to implementing the proposed margin conditions.

Commenters also are invited to address any differences between German requirements and the French and UK requirements that formed the basis for the Commission's conditional grants of substituted compliance for margin in the French and UK Orders.<sup>187</sup> Are there reasons to take a different approach with respect to substituted compliance in a final German amended

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<sup>187</sup> See French Order, 86 FR at 41659; UK Order, 86 FR at 43372.

order than was taken in the French and UK Orders with respect to margin? If so, identify the differences and explain why they should result in a different approach.

B. Trade acknowledgment and verification, and trading relationship documentation

Commenters are invited to address all aspects of the proposed amendments related to trade acknowledgment and verification, and trading relationship documentation. In this regard commenters are invited to address the efficacy of the proposed EMIR-related general conditions. Commenters also are invited to address the proposed removal of MiFID conditions in connection with substituted compliance for the trade acknowledgment and verification requirements and trading relationship documentation requirements.

C. Recordkeeping, Reporting, Notification, and Securities Count Requirements

The Commission requests comment regarding the proposed grant of substituted compliance in connection with requirements under the Exchange Act related to recordkeeping, reporting, notification, and securities counts applicable to SBS Entities without a prudential regulator as well as the requirements of Exchange Act section 15F(g) applicable to all SBS Entities. Commenters particularly are invited to address the basis for substituted compliance in connection with those requirements, and the proposed conditions and limitations connected to substituted compliance for those requirements. Do EU and German requirements taken as a whole produce regulatory outcomes that are comparable to those of Exchange Act section 15F(g) and Exchange Act rules 18a-5, 18a-6, 18a-7, 18a-8, and 18a-9? In this regard, commenters are invited to address the EU and German laws cited for each substituted compliance determination with respect to the distinct requirements within Exchange Act rules 18a-5, 18a-6, 18a-7, and 18a-8 (i.e., the rules for which a more granular approach to substituted compliance is being taken). With respect to each substituted compliance determination, the Commission seeks comment on

the following matters: (1) will the EU and German laws cited for the determination result in a comparable regulatory outcome; (2) are there additional or alternative EU and German laws that should be cited to achieve a comparable regulatory outcome; and (3) are any of the EU and German laws cited for the determination unnecessary to achieve a comparable regulatory outcome?

Commenters particularly are invited to address the proposed condition with respect to Exchange Act rule 18a-5 that a Covered Entity without a prudential regulator preserve all of the data elements necessary to create the records required by Exchange Act rules 18a-5(a)(1), (2), (3), (4), and (7). Do the relevant EU and German laws require Covered Entities without a prudential regulator to retain the data elements necessary to create the records required by these rules? If not, please identify which data elements are not preserved pursuant to the relevant EU and German laws. Further, how burdensome would it be for a Covered Entity without a prudential regulator to format the data elements into the records required by these rules (e.g., a blotter, ledger, or securities record, as applicable) if the firm was requested to do so? In what formats do Covered Entities without a prudential regulator in the Germany produce this information to EU and German authorities? How do those formats differ from the formats required by Exchange Act rules 18a-5(a)(1), (2), (3), (4), and (7)?

Is it appropriate to structure the Commission's substituted compliance determinations in the proposed Amended Order with respect to the recordkeeping, reporting and notification rules to provide Covered Entities with greater flexibility to select which distinct requirements within the broader recordkeeping, reporting, and notification rules for which they want to apply substituted compliance? Explain why or why not. For example, would it be more efficient for a Covered Entity to comply with certain Exchange Act requirements within a given recordkeeping

or reporting rule (rather than apply substituted compliance) because it can utilize systems that its affiliated broker-dealer has implemented to comply with them? If so, explain why. If not, explain why not. Is it appropriate to permit Covered Entities to take a more granular approach to the requirements within these recordkeeping rules? For example, would this approach make it more difficult for the Commission to get a comprehensive understanding of the Covered Entity's security-based swap activities and financial condition? Explain why or why not. Would it be overly complex for the Covered Entity to administer a firm-wide recordkeeping system under this approach? Explain why or why not.

Certain of the Commission's recordkeeping, reporting, and notification requirements are fully or partially linked to substantive Exchange Act requirements for which a preliminary positive substituted compliance determination would not be made under the proposed Amended Order. In these cases, should the Commission not make a positive substituted compliance determination for the fully linked requirement in the recordkeeping, reporting, and notification rules or to the portion of the requirement that is linked to a substantive Exchange Act requirement? Explain why or why not.

Certain of the requirements in the Commission's recordkeeping, reporting, and notification rules are linked to substantive Exchange Act requirements where a preliminary positive substituted compliance determination would be made under the proposed Amended Order. In these cases, should a positive substituted compliance determination for the linked requirement in the recordkeeping, reporting, or notification rule be conditioned on the Covered Entity applying substituted compliance to the linked substantive Exchange Act requirement? If not, explain why. Should this be the case regardless of whether the requirement is fully or partially linked to the substantive Exchange Act requirement? If not, explain why.

While certain recordkeeping and reporting requirements are not expressly linked to Exchange Act rule 18a-1, they would be important to the Commission's ability to monitor or examine for compliance with the capital requirements under this rule. The records also would assist the firm in monitoring its net capital position and, therefore, in complying with Exchange rule 18a-1 and its appendices. Should a positive substituted compliance determination with respect to these recordkeeping and reporting requirements be subject to the condition that the Covered Entity applies substituted compliance with respect to Exchange Act rule 18a-1 and its appendices? If not, explain why.

Commenters also are invited to address the proposal that a positive substituted compliance determination with respect to Exchange Act rule 18a-7 would be conditioned on the Covered Entity without a prudential regulator filing financial and operational information with the Commission in the manner and format specified by the Commission by order or rule. In addition to requesting comment about how Covered Entities without a prudential regulator should meet the Manner and Format Condition, the Commission continues to seek comment on the how Covered Entities with a prudential regulator should meet this condition. With respect to the FOCUS Report Part II, not all of the line items on the report may be as pertinent to a Covered Entity without a prudential regulator if a positive substituted compliance determination is made with respect to capital or margin. With respect to the FOCUS Report Part IIC, because the Commission does not have responsibility to administer capital and margin requirements for prudentially regulated Covered Entities, the FOCUS Report Part IIC elicits much less information than the FOCUS Report Part II or the financial reports Covered Entities file with EU and/or German authorities. Should the Commission require Covered Entities to file the financial and operational information using the FOCUS Report Part II (if not prudentially regulated) or

Part IIC (if prudentially regulated)? Are there line items on the FOCUS Report Part II or Part IIC that elicit information that is not included in the reports Covered Entities file with EU and/or German authorities? If so, do Covered Entities record that information in their required books and records? Please identify any information that is elicited in the FOCUS Report Part II (if not prudentially regulated) or Part IIC (if prudentially regulated) that is not: (1) included in the financial reports filed by Covered Entities with EU and/or German authorities; or (2) recorded in the books and records required of Covered Entities. With respect to the FOCUS Report Part IIC, would the answer to these questions change if references to FFIEC Form 031 were not included in the FOCUS Report Part IIC? If so, how?

As a preliminary matter, as a condition of substituted compliance should Covered Entities file a limited amount of financial and operational information on the FOCUS Report Part II (if not prudentially regulated) or Part IIC (if prudentially regulated) for a period of two years to further evaluate the burden of requiring all applicable line items to be filled out? If so, which line items should be required? To the extent that Covered Entities otherwise report or record information that is responsive to the FOCUS Report Part II or Part IIC, how could the information on these reports be integrated into a database of filings the Commission or its designee will maintain for filers of the FOCUS Report Parts II and IIC (e.g., the eFOCUS system) to achieve the objective of being able to perform cross-form analysis of information entered into the uniquely numbered line items on the forms?

Commenters also are invited to address the proposed conditions to applying substituted compliance for the requirement of Exchange Act rule 18a-7 that Covered Entities without a prudential regulator file annual audited reports. For example, comment is sought on the first and third conditions that the Covered Entity simultaneously transmit to the Commission a copy of the

financial statements the Covered Entity is required to file annually with EU and/or German authorities, and, if not already required, that the Covered Entity engage an independent public accountant to prepare a report covering the annual financial statements. Are there any concerns with the Commission accepting financial statements that are prepared in accordance with EU or German GAAP and audited by an independent public accountant in accordance with EU or German GAAS? In addition, are there any concerns with the public accountant being independent in accordance with EU or German requirements? Further, the third proposed condition would require Covered Entities that are not required under German law to file a report of an independent public accountant covering their financial statements to file such an accountant's report. This proposed condition is based on the fact that German law only requires certain investment firms (depending on their size) to have their financial statements audited. Do the firms in Germany that are not subject to the requirement to file audited financial reports engage in security-based swap activities? If so, are they likely to register with the Commission as a non-prudentially regulated security-based swap dealer or major security-based swap participant?

Commenters also are invited to address any differences between German requirements and the French and UK requirements that formed the basis for the Commission's conditional grants of substituted compliance for recordkeeping, reporting, notification, and securities count requirements in the French and UK Orders.<sup>188</sup> Are there reasons to take a different approach with respect to substituted compliance in a final German amended order than was taken in the French and UK Orders with respect to these requirements? If so, identify the differences and explain why they should result in a different approach.

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<sup>188</sup> See French Order, 86 FR 41648-57; UK Order, 86 FR at 43359-69.



D. Additional aspects of the proposal

Commenters further are invited to address the proposed amendments to the Order related to written notice of a Covered Entity's intent to rely on substituted compliance, regarding the incorporation of references to MiFIR into the general condition related to EU cross-border issues, and the additional MOU condition. Commenters are also invited to address the changes to the requirements for CCO reports, and the provisions added and deleted from the sections on risk control, internal supervision and counterparty protection requirements.

In addition, commenters are invited to address how the Commission should weigh considerations related to supervisory and enforcement effectiveness related to capital and margin, including considerations regarding relevant EU and German supervisory and enforcement authority, practices and tools related to capital and margin.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority,<sup>189</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>189</sup> 17 CFR 200.30-3(a)(89).

**Attachment A**

**IT IS HEREBY DETERMINED AND ORDERED, pursuant to rule 3a71-6 under the Exchange Act, that a Covered Entity (as defined in paragraph (g)(1) of this Order) may satisfy the requirements under the Exchange Act that are addressed in paragraphs (b) through (f) of this Order so long as the Covered Entity is subject to and complies with relevant requirements of the Federal Republic of Germany and the European Union and with the conditions of this Order, as amended or superseded from time to time.**

**(a) General conditions.**

This Order is subject to the following general conditions, in addition to the conditions specified in paragraphs (b) through (f):

(1) Activities as MiFID “investment services or activities.” For each condition in paragraphs (b) through (f) of this Order that requires the application of, and the Covered Entity’s compliance with, provisions of MiFID, provisions of WpHG that implement MiFID, and/or other EU and German requirements adopted pursuant to those provisions, the Covered Entity’s relevant security-based swap activities constitute “investment services” or “investment activities,” as defined in MiFID article 4(1)(2) and in WpHG section 2(8), and fall within the scope of the Covered Entity’s authorization from BaFin to provide investment services and/or perform investment activities in the Federal Republic of Germany.

(2) Counterparties as MiFID “clients.” For each condition in paragraphs (b) through (f) of this Order that requires the application of, and the Covered Entity’s compliance with, provisions of MiFID, provisions of WpHG that implement MiFID and/or other EU and German

requirements adopted pursuant to those provisions, the relevant counterparty (or potential counterparty) to the Covered Entity is a “client” (or potential “client”), as defined in MiFID article 4(1)(9) and in WpHG section 67(1).

(3) Security-based swaps as MiFID “financial instruments.” For each condition in paragraphs (b) through (f) of this Order that requires the application of, and the Covered Entity’s compliance with, provisions of MiFID, provisions of WpHG that implement MiFID and/or other EU and German requirements adopted pursuant to those provisions, the relevant security-based swap is a “financial instrument,” as defined in MiFID article 4(1)(15) and in WpHG section 2(4).

(4) Covered Entity as CRD/CRR “institution.” For each condition in paragraphs (b) through (f) of this Order that requires the application of, and the Covered Entity’s compliance with, the provisions of CRD, provisions of KWG that implement CRD, CRR and/or other EU and German requirements adopted pursuant to those provisions, the Covered Entity is an “institution,” as defined in CRD article 3(1)(3), in CRR article 4(1)(3) and in KWG section 1(1b).

(5) Counterparties as EMIR “counterparties.” For each condition in paragraphs (b) through (f) of this Order that requires the application of, and the Covered Entity’s compliance with, provisions of EMIR, EMIR RTS, EMIR Margin RTS and/or other EU requirements adopted pursuant to those provisions, if the relevant provision applies only to the Covered Entity’s activities with specified types of counterparties, and if the counterparty to the Covered Entity is not any of the specified types of counterparty, the Covered Entity complies with the applicable condition of this Order:

(i) As if the counterparty were the specified type of counterparty; in this regard, if the Covered Entity reasonably determines that the counterparty would be a financial counterparty if

it were established in the EU and authorized by an appropriate EU authority, it must treat the counterparty as if the counterparty were a financial counterparty; and

(ii) Without regard to the application of EMIR article 13.

(6) Security-based swap status under EMIR. For each condition in paragraphs (b) through (f) of this Order that requires the application of, and the Covered Entity's compliance with, provisions of EMIR and/or other EU requirements adopted pursuant to those provisions, either:

(i) The relevant security-based swap is an "OTC derivative" or "OTC derivative contract," as defined in EMIR article 2(7), that has not been cleared by a central counterparty and otherwise is subject to the provisions of EMIR article 11, EMIR RTS articles 11-15, and EMIR Margin RTS article 2; or

(ii) The relevant security-based swap has been cleared by a central counterparty that is authorized or recognized to clear derivatives contracts by a relevant authority in the EU.

(7) Memorandum of Understanding with BaFin. The Commission and BaFin have a supervisory and enforcement memorandum of understanding and/or other arrangement addressing cooperation with respect to this Order at the time the Covered Entity complies with the relevant requirements under the Exchange Act via compliance with one or more provisions of this Order.

(8) Memorandum of Understanding Regarding ECB-Owned Information. The Commission and the ECB have a supervisory and enforcement memorandum of understanding and/or other arrangement addressing cooperation with respect to this Order as it pertains to information owned by the ECB at the time the Covered Entity complies with the relevant requirements under the Exchange Act via compliance with one or more provisions of this Order.

(9) Notice to Commission. A Covered Entity relying on this Order must provide notice of its intent to rely on this Order by notifying the Commission in writing. Such notice must be sent to the Commission in the manner specified on the Commission's website. The notice must include the contact information of an individual who can provide further information about the matter that is the subject of the notice. The notice must also identify each specific substituted compliance determination within paragraphs (b) through (f) of the Order for which the Covered Entity intends to apply substituted compliance. A Covered Entity must promptly provide an amended notice if it modifies its reliance on the substituted compliance determinations in this Order.

(10) European Union Cross-Border Matters.

(i) If, in relation to a particular service provided by a Covered Entity, responsibility for ensuring compliance with any provision of MiFID or MiFIR or any other EU or German requirement adopted pursuant to MiFID or MiFIR listed in paragraphs (b) through (f) of this Order is allocated to an authority of the Member State of the European Union in whose territory a Covered Entity provides the service, BaFin must be the authority responsible for supervision and enforcement of that provision or requirement in relation to the particular service.

(ii) If responsibility for ensuring compliance with any provision of MAR or any other EU requirement adopted pursuant to MAR listed in paragraphs (b) through (f) of this Order is allocated to one or more authorities of a Member State of the European Union, one of such authorities must be BaFin.

(11) Notification Requirements Related to Changes in Capital. A Covered Entity that is prudentially regulated relying on this Order must apply substituted compliance with respect to

the requirements of Exchange Act rule 18a-8(c) and the requirements of Exchange Act rule 18a-8(h) as applied to Exchange Act rule 18a-8(c).

**(b) Substituted compliance in connection with risk control requirements.**

This Order extends to the following provisions related to risk control:

(1) Internal risk management. The requirements of Exchange Act section 15F(j)(2) and related aspects of Exchange Act rule 15Fh-3(h)(2)(iii)(I), provided that the Covered Entity is subject to and complies with the requirements of: MiFID articles 16 and 23; WpHG sections 63, 80, 83 and 84; MiFID Org Reg articles 21-37, 72-76 and Annex IV; CRD articles 74, 76 and 79-87, 88(1), 91(1)-(2), 91(7)-(9) and 92, 94 and 95; and KWG sections 25a, 25b, 25c (other than 25c(2)), 25d (other than 25d(3) and 25d(11)), 25e and 25f; CRR articles 286-88 and 293; and EMIR Margin RTS article 2.

(2) Trade acknowledgement and verification. The requirements of Exchange Act rule 15Fi-2, provided that the Covered Entity is subject to and complies with the requirements of EMIR article 11(1)(a) and EMIR RTS article 12.

(3) Portfolio reconciliation and dispute reporting. The requirements of Exchange Act rule 15Fi-3, provided that:

(i) The Covered Entity is subject to and complies with the requirements of EMIR article 11(1)(b) and EMIR RTS articles 13 and 15; and

(ii) The Covered Entity provides the Commission with reports regarding disputes between counterparties on the same basis as it provides those reports to competent authorities pursuant to EMIR RTS article 15(2).

(4) Portfolio compression. The requirements of Exchange Act rule 15Fi-4, provided that the Covered Entity is subject to and complies with the requirements of EMIR RTS article 14.

(5) Trading relationship documentation. The requirements of Exchange Act rule 15Fi-5, other than paragraph (b)(5) to that rule when the counterparty is a U.S. person, provided that the Covered Entity is subject to and complies with the requirements of EMIR article 11(1)(a), EMIR RTS article 12, and EMIR Margin RTS article 2.

**(c) Substituted compliance in connection with capital and margin**

(1) Capital. The requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1, and 18a-1a through d, provided that:

(i) The Covered Entity is subject to and complies with: CRR, Part One (General Provisions) Article 6(1), Part Two (Own Funds), Part Three (Capital Requirements), Part Four (Large Exposures), Part Five (Exposures to Transferred Credit Risk), Part Six (Liquidity), and Part Seven (Leverage); MiFID Org Reg article 23; BRRD, articles 45(6) and 81(1); CRD, articles 73, 79, 86, 129, 129(1), 130, 130(1), 130(5), 131, 133, 133(1), 133(4), 141, 142(1) and (2); EMIR Margin RTS, articles 2, 3(b), 7, and 19(1)(d) and (e), (3) and (8); KWG, sections 10b-10h, 10i(2)-(9), 25a(1) sentence 3 no. 2 and no. 3 b), 33(1) sentence 1c); SAG, section 49(2), 49d, 62(1), 138(1); and SolvV, section 37;

(ii) The Covered Entity applies substituted compliance for the requirements of Exchange Act rules 18a-5(a)(9), 18a-6(b)(1)(x), and 18a-8(a)(1)(i), (a)(1)(ii), (b)(1), (b)(2), and (b)(4) pursuant to this Order; and

(iii)(A) The Covered Entity:

(I) Maintains liquid assets as defined in paragraph (c)(1)(iii)(B) that have an aggregate market value that exceeds the amount of the Covered Entity's total liabilities by at least \$100 million before applying the deduction specified in paragraph (c)(1)(iii)(C) and by at least \$20 million after applying the deduction specified in paragraph (c)(1)(iii)(C);

(2) Makes and preserves for three years a quarterly record that:

(a) Identifies and values the liquid assets maintained pursuant to paragraph

(c)(1)(iii)(A)(I);

(b) Compares the amount of the aggregate value the liquid assets maintained pursuant to paragraph (c)(1)(iii)(A)(I) to the amount of the Covered Entity's total liabilities and shows the amount of the difference between the two amounts ("the excess liquid assets amount"); and

(c) Shows the amount of the deduction specified in paragraph (c)(1)(iii)(C) and the amount that deduction reduces the excess liquid assets amount;

(3) The Covered Entity notifies the Commission in writing within 24 hours in the manner specified on the Commission's website if the Covered Entity fails to meet the requirements of paragraph (c)(iii)(A)(I) and includes in the notice the contact information of an individual who can provide further information about the failure to meet the requirements; and

(4) Includes its most recent statement of financial condition filed with its local supervisor (whether audited or unaudited) with its initial written notice to the Commission of its intent to rely on substituted compliance under condition (a)(9) above.

(B) For the purposes of paragraph (c)(1)(iii)(A)(I), liquid assets are:

(1) Cash and cash equivalents;

(2) Collateralized agreements;

(3) Customer and other trading related receivables;

(4) Trading and financial assets; and

(5) Initial margin posted by the Covered Entity to a counterparty or a third-party custodian, provided:



(a) The initial margin requirement is funded by a fully executed written loan agreement with an affiliate of the Covered Entity;

(b) The loan agreement provides that the lender waives re-payment of the loan until the initial margin is returned to the Covered Entity; and

(c) The liability of the Covered Entity to the lender can be fully satisfied by delivering the collateral serving as initial margin to the lender.

(C) The deduction required by paragraph (c)(1)(iii)(A) is the amount of the Covered Entity's risk-weighted assets calculated for the purposes of the capital requirements identified in paragraph (c)(1)(i) divided by 12.5.

(2) Margin. The requirements of Exchange Act section 15F(e) and Exchange Act rule 18a-3, provided that:

(i) The Covered Entity is subject to and complies with the requirements of: EMIR article 11; EMIR Margin RTS; CRR articles 103, 105(3); 105(10); 111(2), 224, 285, 286, 286(7), 290, 295, 296(2)(b), 297(1), 297(3), and 298(1); MiFID Org Reg article 23(1); CRD articles 74 and 79(b); and KWG section 25a(1);

(ii) The Covered Entity collects variation margin, as defined in EMIR Margin RTS, from a counterparty with respect to transactions in non-cleared security-based swaps, unless the counterparty would qualify for an exception from the collateral collection requirements under paragraph (c)(1)(iii) or (c)(2)(iii) of Exchange Act 18a-3;

(iii) The Covered Entity collects initial margin, as defined in the EMIR Margin RTS, from a counterparty with respect to transactions in non-cleared security-based swaps, unless the counterparty would qualify for an exception from the collateral collection requirements under paragraph (c)(1)(iii) of Exchange Act rule 18a-3; and

(iv) The Covered Entity applies substituted compliance for the requirements of Exchange Act rule 18a-5(a)(12) pursuant to this Order.

**(d) Substituted compliance in connection with internal supervision and compliance requirements and certain Exchange Act section 15F(j) requirements.**

This Order extends to the following provisions related to internal supervision and compliance and Exchange Act section 15F(j) requirements:

(1) Internal supervision. The requirements of Exchange Act rule 15Fh-3(h) and Exchange Act sections 15F(j)(4)(A) and (j)(5), provided that:

(i) The Covered Entity is subject to and complies with the requirements identified in paragraph (d)(3) of this Order;

(ii) The Covered Entity complies with paragraph (d)(4) of this Order; and

(iii) This paragraph (d) does not extend to the requirements of paragraph (h)(2)(iii)(I) to rule 15Fh-3 to the extent those requirements pertain to compliance with Exchange Act sections 15F(j)(2), (j)(3), (j)(4)(B) and (j)(6), or to the general and supporting provisions of paragraph (h) to rule 15Fh-3 in connection with those Exchange Act sections.

(2) Chief compliance officers. The requirements of Exchange Act section 15F(k) and Exchange Act rule 15Fk-1, provided that:

(i) The Covered Entity is subject to and complies with the requirements identified in paragraph (d)(3) of this Order;

(ii) All reports required pursuant to MiFID Org Reg article 22(2)(c) must also:

(A) Be provided to the Commission at least annually, and in the English language;

(B) Include a certification signed by the chief compliance officer or senior officer (as defined in Exchange Act rule 15Fk-1(e)(2)) of the Covered Entity that, to the best of the

certifier's knowledge and reasonable belief and under penalty of law, the report is accurate and complete in all material respects;

(C) Address the Covered Entity's compliance with:

(i) Applicable requirements under the Exchange Act; and

(ii) The other applicable conditions of this Order in connection with requirements for which the Covered Entity is relying on this Order;

(D) Be provided to the Commission no later than 15 days following the earlier of:

(i) The submission of the report to the Covered Entity's management body; or

(ii) The time the report is required to be submitted to the management body; and

(E) Together cover the entire period that the Covered Entity's annual compliance report referenced in Exchange Act section 15F(k)(3) and Exchange Act rule 15Fk-1(c) would be required to cover.

(3) Applicable supervisory and compliance requirements. Paragraphs (d)(1) and (d)(2) are conditioned on the Covered Entity being subject to and complying with the following requirements: MiFID articles 16 and 23; WpHG sections 63, 80, 83 and 84; MiFID Org Reg articles 21-37, 72-76 and Annex IV; CRD articles 74, 76, 79-87, 88(1), 91(1)-(2), 91(7)-(9) and 92, 94 and 95; and KWG sections 25a, 25b, 25c (other than 25c(2)), 25d (other than 25d(3) and 25d(11)), 25e and 25f, and CRR articles 286-88 and 293; and EMIR Margin RTS article 2.

(4) Additional condition to paragraph (d)(1). Paragraph (d)(1) further is conditioned on the requirement that the Covered Entity complies with the provisions specified in paragraph (d)(3) as if those provisions also require compliance with:

(i) Applicable requirements under the Exchange Act; and

(ii) The other applicable conditions of this Order in connection with requirements for which the Covered Entity is relying on this Order.

**(e) Substituted compliance in connection with counterparty protection requirements.**

This Order extends to the following provisions related to counterparty protection:

(1) Disclosure of information regarding material risks and characteristics. The requirements of Exchange Act rule 15Fh-3(b) relating to disclosure of material risks and characteristics of one or more security-based swaps subject thereto, provided that the Covered Entity, in relation to that security-based swap, is subject to and complies with the requirements of MiFID article 24(4), WpHG sections 63(7) and 64(1) and MiFID Org Reg articles 48-50.

(2) Disclosure of information regarding material incentives or conflicts of interest. The requirements of Exchange Act rule 15Fh-3(b) relating to disclosure of material incentives or conflicts of interest that a Covered Entity may have in connection with one or more security-based swaps subject thereto, provided that the Covered Entity, in relation to that security-based swap, is subject to and complies with the requirements of either:

(i) MiFID article 23(2)-(3); WpHG section 63(2); and MiFID Org Reg articles 33-35;

(ii) MiFID article 24(9); WpHG section 70; and MiFID Delegated Directive article 11(5);

or

(iii) MAR article 20(1) and MAR Investment Recommendations Regulation articles 5 and 6.

(3) “Know your counterparty.” The requirements of Exchange Act rule 15Fh-3(e), as applied to one or more security-based swap counterparties subject thereto, provided that the Covered Entity, in relation to the relevant security-based swap counterparty, is subject to and complies with the requirements of MiFID article 16(2); WpHG section 80(1); MiFID Org Reg articles 21-22, 25-26 and applicable parts of Annex I; CRD articles 74(1) and 85(1); KWG section 25a; MLD articles 11 and 13; GwG sections 10-11; MLD articles 8(3) and 8(4)(a) as

applied to internal policies, controls and procedures regarding recordkeeping of customer due diligence activities; and GwG section 6(1)-(2) as applied to vigilance measures regarding recordkeeping of customer due diligence activities.

(4) Suitability. The requirements of Exchange Act rule 15Fh-3(f), as applied to one or more recommendations of a security-based swap or trading strategy involving a security-based swap subject thereto, provided that:

(i) The Covered Entity, in relation to the relevant recommendation, is subject to and complies with the requirements of MiFID articles 24(2)-(3) and 25(1)-(2);; WpHG sections 63(5)-(6), 80(9)-(13) and 87(1)-(2); and MiFID Org Reg articles 21(1)(b) and (d), 54 and 55; and

(ii) The counterparty to which the Covered Entity makes the recommendation is a “professional client” mentioned in MiFID Annex II section I and WpHG section 67(2) and is not a “special entity” as defined in Exchange Act section 15F(h)(2)(C) and Exchange Act rule 15Fh-2(d).

(5) Fair and balanced communications. The requirements of Exchange Act rule 15Fh-3(g), as applied to one or more communications subject thereto, provided that the Covered Entity, in relation to the relevant communication, is subject to and complies with the requirements of:

(i) Either MiFID articles 24(1), (3) and WpHG sections 63(1), (6) or MiFID article 30(1) and WpHG section 68(1); and

(ii) MiFID articles 24(4)-(5); WpHG sections 63(7) and 64(1); MiFID Org Reg articles 46-48; MAR articles 12(1)(c), 15 and 20(1); and MAR Investment Recommendations Regulation articles 3 and 4.

(6) Daily mark disclosure. The requirements of Exchange Act rule 15Fh-3(c), as applied to one or more security-based swaps subject thereto, provided that the Covered Entity is required to reconcile, and does reconcile, the portfolio containing the relevant security-based swap on each business day pursuant to EMIR articles 11(1)(b) and 11(2) and EMIR RTS article 13.

**(f) Substituted compliance in connection with recordkeeping, reporting, notification, and securities count requirements.**

This Order extends to the following provisions that apply to a Covered Entity related to recordkeeping, reporting, notification and securities counts:

(1)(i) Make and keep current certain records. The requirements of the following provisions of Exchange Act rule 18a-5, provided that the Covered Entity complies with the relevant conditions in this paragraph (f)(1)(i) and with the applicable conditions in paragraph (f)(1)(ii):

(A) The requirements of Exchange Act rule 18a-5(a)(1) or (b)(1), as applicable, provided that:

(1) The Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 74, 75, and Annex IV; and MiFIR article 25(1); and

(2) With respect to the requirements of Exchange Act rule 18a-5(a)(1), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order.

(B) The requirements of Exchange Act rule 18a-5(a)(2), provided that:

(1) The Covered Entity is subject to and complies with the requirements of CRD article 73; MiFID Delegated Directive article 2; MiFID Org Reg articles 72, 74 and 75; EMIR article 39(4); KWG section 10a; and WpHG section 84; and

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(C) The requirements of Exchange Act rule 18a-5(a)(3) or (b)(2), as applicable, provided that:

(1) The Covered Entity is subject to and complies with the requirements of MiFID Delegated Directive article 2; MiFID Org Reg articles 72, 74 and 75; EMIR article 39(4); and WpHG section 84; and

(2) With respect to the requirements of Exchange Act rule 18a-5(a)(3), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(D) The requirements of Exchange Act rule 18a-5(a)(4) or (b)(3), as applicable, provided that:

(1) The Covered Entity is subject to and complies with the requirements of CRR article 103; MiFID articles 16(6), 25(5), and 25(6); MiFID Org Reg articles 59, 74, 75 and Annex IV; MiFIR article 25(1); EMIR articles 9(2) and 11(1)(a); WpHG sections 63 and 64; and

(2) With respect to the requirements of Exchange Act rule 18a-5(a)(4), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(E) The requirements of Exchange Act rule 18a-5(b)(4) provided that the Covered Entity is subject to and complies with the requirements of MiFID Org Reg article 59; EMIR articles 9(2) and 11(1)(a); MiFID articles 16(6), 25(5), and 25(6); and WpHG sections 63, 64, and 83 paragraphs 1 and 2;

(F) The requirements of Exchange Act rule 18a-5(a)(5) or (b)(5), as applicable, provided that:

(1) The Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 74, 75 and Annex IV; and MiFIR article 25(1); and

(2) With respect to the requirements of Exchange Act rule 18a-5(a)(5), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(G) The requirements of Exchange Act rules 18a-5(a)(6) and (a)(15) or (b)(6) and (b)(11), as applicable, provided that:

(1) The Covered Entity is subject to and complies with the requirements of CRR articles 103, 105(3), and 105(10); CRD article 73; MiFID articles 16(6), 25(5), 25(6); MiFID Delegated Directive article 2; MiFID Org Reg articles 59, 74, 75, and Annex IV; MiFIR article 25(1); EMIR articles 9(2), 11(1)(a), and 39(4); KWG section 10a; and WpHG sections 63, 64, 83 paragraphs 1 through 2, and 84; and

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act rule 15Fi-2 pursuant to this Order;

(H) The requirements of Exchange Act rule 18a-5(a)(7) or (b)(7), as applicable, provided that:

(1) The Covered Entity is subject to and complies with the requirements of MiFIR article 25(1); MLD4 articles 11 and 13; MiFID article 25(2); WpHG section 64 paragraph 3; and GWG sections 10 and 11; and



(2) With respect to the requirements of Exchange Act rule 18a-5(a)(7), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(I) The requirements of Exchange Act rule 18a-5(a)(8), provided that:

(1) The Covered Entity is subject to and complies with the requirements of CRR articles 103, 105(3), and 105(10); MiFID Org Reg articles 59, 74, 75 and Annex IV; MiFIR article 25(1); EMIR articles 9(2), 11(1)(a), and 39(4); MiFID articles 16(6), 25(5), and 25(6); CRD article 73; MiFID Delegated Directive article 2; WpHG sections 63, 64, 83 paragraphs 1 through 2, and 84; and KWG section 10a; and

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order.;

(J) The requirements of Exchange Act rule 18a-5(a)(9), provided that:

(1) The Covered Entity is subject to and complies with the requirements of CRD article 73; MiFID Delegated Directive article 2; EMIR article 39(4); MiFID Org Reg articles 72, 74, and 75; KWG section 10a; and WpHG Section 84;

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order; and

(3) This Order does not extend to the requirements of Exchange Act rule 18a-5(a)(9) relating to Exchange Act rule 18a-2;

(K) The requirements of Exchange Act rule 18a-5(a)(10) and (b)(8), provided that the Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 21(1)(d), 35; CRD articles 88, 91(1), 91(8); MiFID article 9(1) and 16(3); KWG sections 15,

25a(1), 25c(1) through (3), 25c(4a), 25d(1) through (3), 25d(7), 25d(11), and 36; and WpHG sections 81(1) and 84;

(L) The requirements of Exchange Act rule 18a-5(a)(12), provided that:

(1) The Covered Entity is subject to and complies with the requirements of CRR articles 103, 105(3) and 105(10); MiFID Org Reg. articles 72, 74 and 75; CRD article 73; MiFID Delegated Directive article 2; KWG section 10a; and WpHG section 84; and

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rule 18a-3 pursuant to this Order;

(M) The requirements of Exchange Act rule 18a-5(a)(17) and (b)(13), as applicable, regarding one or more provisions of Exchange Act rules 15Fh-3 or 15Fk-1 for which substituted compliance is available under this Order, provided that:

(1) The Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 72, 73, and Annex I; MiFID articles 16(6) and 25(2); MLD articles 11 and 13; EMIR article 39(5); WpHG sections 64 paragraph 3 and 83 paragraph 1; and GWG sections 10 and 11, in each case with respect to the relevant security-based swap or activity;

(2) With respect to the portion of Exchange Act rule 18a-5(a)(17) and (b)(13) that relates to Exchange Act rule 15Fh-3, the Covered Entity applies substituted compliance for such business conduct standard(s) of Exchange Act rule 15Fh-3 pursuant to this Order, as applicable, with respect to the relevant security-based swap or activity; and

(3) With respect to the portion of Exchange Act rule 18a-5(a)(17) and (b)(13) that relates to Exchange Act rule 15Fk-1, the Covered Entity applies substituted compliance for Exchange Act section 15F(k) and Exchange Act rule 15Fk-1 pursuant to this Order;

(N) The requirements of Exchange Act rule 18a-5(a)(18)(i) and (ii) or (b)(14)(i) and (ii), as applicable, provided that:

(1) The Covered Entity is subject to and complies with the requirements of EMIR article 11(1)(b); and EMIR RTS article 15(1)(a); and

(2) The Covered Entity applies substituted compliance for Exchange Act rule 15Fi-3 pursuant to this Order; and

(O) The requirements of Exchange Act rule 18a-5(a)(18)(iii) or (b)(14)(iii), as applicable, provided that:

(1) The Covered Entity is subject to and complies with the requirements of EMIR article 11(1)(b); and EMIR RTS article 15(1)(a), in each case with respect to such security-based swap portfolio(s); and

(2) The Covered Entity applies substituted compliance for Exchange Act rule 15Fi-4 pursuant to this Order.

(ii) Paragraph (f)(1)(i) is subject to the following further conditions:

(A) Paragraphs (f)(1)(i)(A) through (D) and (H) are subject to the condition that the Covered Entity preserves all of the data elements necessary to create the records required by the applicable Exchange Act rules cited in such paragraphs and upon request furnishes promptly to representatives of the Commission the records required by those rules;

(B) A Covered Entity may apply the substituted compliance determination in paragraph (f)(1)(i)(M) to records of compliance with Exchange Act rule 15Fh-3(b), (c), (e), (f) and (g) in respect of one or more security-based swaps or activities related to security-based swaps; and

(C) This Order does not extend to the requirements of Exchange Act rule 18a-5(a)(13), (a)(14), (a)(16), (b)(9), (b)(10) or (b)(12).

(2)(i) *Preserve certain records.* The requirements of the following provisions of Exchange Act rule 18a-6, provided that the Covered Entity complies with the relevant conditions in this paragraph (f)(2)(i) and with the applicable conditions in paragraph (f)(2)(ii):

(A) The requirements of Exchange Act rule 18a-6(a)(1) or (a)(2), as applicable, provided that the Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 72, 74, 75, and Annex IV; CRR article 103; MiFIR article 25(1); EMIR article 9(2); MiFID articles 16(6) and 69(2); CRD article 73; MiFID Delegated Directive article 2; WpHG sections 6, 7, 83 paragraph 1, and 84; and KWG section 10a;

(B) The requirements of Exchange Act rule 18a-6(b)(1)(i) or (b)(2)(i), as applicable, provided that the Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 72, 74, 75, and Annex IV; CRR article 103; MiFIR article 25(1); EMIR article 9(2); MiFID articles 16(6) and 69(2); CRD article 73; MiFID Delegated Directive article 2; WpHG sections 6, 7, 83 paragraph 1, and 84; and KWG section 10a;

(C) The requirements of Exchange Act rule 18a-6(b)(1)(ii) and (iii), provided that:

(1) The Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 72, 74 and 75; EMIR article 9(2); CRD article 73; MiFID Delegated Directive article 2; MiFID 16(6); KWG section 10a; and WpHG sections 83 paragraph 1, and 84; and

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(D) The requirements of Exchange Act rule 18a-6(b)(1)(iv) or (b)(2)(ii), as applicable, provided that the Covered Entity is subject to and complies with the requirements of CRR article 103; MiFID Org Reg articles 72, 73, 74, 75, 76, Annex I and Annex IV; MiFIR article 25(1);

EMIR article 9(2); CRD article 73; MiFID articles 16(6), 16(7); MiFID Delegated Directive article 2; KWG section 10a; and WpHG sections 83 paragraphs 1 and 3 through 8, and 84;

(E) The requirements of Exchange Act rule 18a-6(b)(1)(v), provided that:

(1) The Covered Entity is subject to and complies with the requirements of EMIR article 9(2); CRR articles 99, 294, 394, 415, 430 and Part Six: Title II and Title III; CRR Reporting ITS article 14 and annexes I-V and VIII-XIII; and MiFID Org Reg article 72(1);

(2) With respect to the requirements of Exchange Act rule 18a-6(b)(1)(v), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant this Order; and

(3) This Order does not extend to the requirements of Exchange Act rule 18a-6(b)(1)(v) relating to Exchange Act rule 18a-2;

(F) The requirements of Exchange Act rule 18a-6(b)(1)(vi) or (b)(2)(iii), as applicable, provided that:

(1) The Covered Entity is subject to and complies with the requirements of EMIR article 9(2); MiFID Org Reg articles 72(1) and 73; MiFID article 16(6); and WpHG section 83 paragraph 1; and

(2) With respect to the requirements of Exchange Act rule 18a-6(b)(1)(vi), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(G) The requirements of Exchange Act rule 18a-6(b)(1)(vii) or (b)(2)(iv), as applicable, provided that:

(I) The Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 72(1) and 73; MiFIR article 25(1); EMIR article 9(2); MiFID article 16(6); and WpHG section 83 paragraph 1; and

(2) With respect to the requirements of Exchange Act rule 18a-6(b)(1)(vii), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(H) The requirements of Exchange Act rule 18a-6(b)(1)(viii), provided that:

(I) The Covered Entity is subject to and complies with the requirements of CRR articles 99, 294, 394, 415, 430 and Part Six: Title II and Title III; CRR Reporting ITS article 14 and annexes I-V and VIII-XIII, as applicable; and MiFID Org Reg article 72(1);

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act rule 18a-7(a)(1), (b), (c) through (h), and Exchange Act rule 18a-7(j) as applied to these requirements pursuant to this Order;

(3) With respect to the requirements of Exchange Act rule 18a-6(b)(1)(viii), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(4) This Order does not extend to the requirements of Exchange Act rule 18a-6(b)(1)(viii)(L); and

(5) This Order does not extend to the requirements of Exchange Act rule 18a-6(b)(1)(viii)(M) relating to Exchange Act rule 18a-2.

(I) The requirements of Exchange Act rule 18a-6(b)(1)(ix), provided that:

(I) The Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 22(3)(c), 23, 24, 25(2), 26, 29(2)(c), 35 and 72(1); CRR articles 176, 286 and

293(1)(d); EMIR RTS; EMIR article 9(2); MiFID articles 16(2), 16(3), 16(5), 24(9); MiFID Delegated Directive article 11; CRD article 73, 75-87; WpHG sections 64 paragraph 3, 70, 80 paragraph 6, and 84; WpDVerOV section 6; and KWG sections 10a, 25a, 25c(3)(3), 25c(3)(4), 25c(4a), 25d(6), 25(8); and

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(J) The requirements of Exchange Act rule 18a-6(b)(1)(x), provided that:

(1) The Covered Entity is subject to and complies with the requirements of EMIR article 9(2); MiFID Org Reg article 72(1); CRD article 73; MiFID article 16(6); KWG section 10a; and WpHG section 83 paragraph 1; and

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(K) The requirements of Exchange Act rule 18a-6(b)(1)(xii) or (b)(2)(vii), as applicable, regarding one or more provisions of Exchange Act rules 15Fh-3 or 15Fk-1 for which substituted compliance is available under this Order, provided that:

(1) The Covered Entity is subject to and complies with the requirements of EMIR article 9(2); MLD4 articles 11 and 13; MiFID Org Reg article 72(1); MiFID article 16(6); GWG sections 10 and 11; and WpHG section 83 paragraph 1, in each case with respect to the relevant security-based swap or activity;

(2) With respect to the portion of Exchange Act rule 18a-6(b)(1)(xii) or (b)(2)(vii) that relates to Exchange Act rule 15Fh-3, the Covered Entity applies substituted compliance for such business conduct standard(s) of Exchange Act rule 15Fh-3 pursuant to this Order, as applicable, with respect to the relevant security-based swap or activity; and

(3) With respect to the portion of Exchange Act rule 18a-6(b)(1)(xii) or (b)(2)(vii), as applicable, that relates to Exchange Act rule 15Fk-1, the Covered Entity applies substituted compliance for Exchange Act section 15F(k) and Exchange Act rule 15Fk-1 pursuant to this Order;

(L) The requirements of Exchange Act rule 18a-6(c), provided that:

(1) The Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 21(1)(f) and 72(1); MiFID article 16(6); and WpHG section 83 paragraph 1; and

(2) This Order does not extend to the requirements of Exchange act rule 18a-6(c) relating to Forms SBSE, SBSE-A, SBSE-C, SBSE-W, all amendments to these forms, and all other licenses or other documentation showing the registration of the Covered Entity with any securities regulatory authority or the U.S. Commodity Futures Trading Commission;

(M) The requirements of Exchange Act rule 18a-6(d)(1), provided that the Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 35 and 72(1); CRD articles 88, 91(1), 91(8); MiFID article 9(1), 16(3), 16(6); KWG sections 25c(1) through (3), 25d(1) through (3), and 36; and WpHG sections 81(1), 83 paragraph 1, and 84;

(N) The requirements of Exchange Act rule 18a-6(d)(2), provided that:

(1) The Covered Entity is subject to and complies with the requirements of EMIR article 9(2); MiFID Org Reg articles 72(1) and 72(3); MiFID article 16(6); and WpHG section 83 paragraph 1; and

(2) With respect to the requirements of Exchange Act rule 18a-6(d)(2)(i), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(O) The requirements of Exchange Act rule 18a-6(d)(3), provided that:



(I) The Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 21(1)(f), 72, 73, and Annex I; MiFID article 16(6); and WpHG section 83 paragraph 1; and

(2) With respect to the requirements of Exchange Act rule 18a-6(d)(3)(i), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(P) The requirements of Exchange Act rule 18a-6(d)(4) and (d)(5), provided that:

(I) The Covered Entity is subject to and complies with the requirements of EMIR article 9(2); MiFID Org Reg articles 24, 25(2), 72(1) and 73; MiFID articles 16(2), 16(6), and 25(5); and WpHG sections 64 paragraph 3 and 83 paragraphs 1 and 2; and

(2) The Covered Entity applies substituted compliance for Exchange Act rules 15Fi-3, 15Fi-4, and 15Fi-5 pursuant to this Order;

(Q) The requirements of Exchange Act rule 18a-6(e), provided that the Covered Entity is subject to and complies with the requirements of MiFID Org Reg articles 21(2), 58, 72(1) and 72(3); MiFID articles 16(5), 16(6); and WpHG sections 80 paragraph 6, and 83 paragraph 1; and

(R) The requirements of Exchange Act rule 18a-6(f), provided that the Covered Entity is subject to and complies with the requirements of MiFID Org Reg article 31(1); MiFID article 16(5); and WpHG section 80 paragraph 6.

(ii) Paragraph (f)(2)(i) is subject to the following further conditions:

(A) A Covered Entity may apply the substituted compliance determination in paragraph (f)(2)(i)(K) to records related to Exchange Act rule 15Fh-3(b), (c), (e), (f) and (g) in respect of one or more security-based swaps or activities related to security-based swaps; and

(B) This Order does not extend to the requirements of Exchange Act rule 18a-6(b)(1)(xi), (b)(1)(xiii), (b)(2)(v), (b)(2)(vi), or (b)(2)(viii).

(3) *File Reports.* The requirements of the following provisions of Exchange Act rule 18a-7, provided that the Covered Entity complies with the relevant conditions in this paragraph (f)(3):

(i) The requirements of Exchange Act rule 18a-7(a)(1) or (a)(2), as applicable, and the requirements of Exchange Act rule 18a-7(j) as applied to the requirements of Exchange Act rule 18a-7(a)(1) or (a)(2), as applicable, provided that:

(A) The Covered Entity is subject to and complies with the requirements of CRR articles 99, 394, 430 and Part Six: Title II and Title III; CRR Reporting ITS annexes I, II, III, IV, V, VIII, IX, X, XI, XII and XIII, as applicable;

(B) The Covered Entity files periodic unaudited financial and operational information with the Commission or its designee in the manner and format required by Commission rule or order and presents the financial information in the filing in accordance with generally accepted accounting principles that the Covered Entity uses to prepare general purpose publicly available or available to be issued financial statements in Germany;

(C) With respect to the requirements of Exchange Act rule 18a-7(a)(1), the Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order; and

(D) With respect to the requirements of Exchange Act rule 18a-7(a)(1), the Covered Entity applies substituted compliance for the requirements of Exchange Act rule 18a-6(b)(1)(viii) pursuant to this Order;

(ii) The requirements of Exchange Act rule 18a-7(a)(3) and the requirements of Exchange Act rule 18a-7(j) as applied to the requirements of Exchange Act rule 18a-7(a)(3), provided that:

(A) The Covered Entity is subject to and complies with the requirements of CRR articles 99, 394, 431, 433,452, 454, and 455; CRR Reporting ITS annexes I, II, VIII and IX, as applicable; and

(B) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(iii) The requirements of Exchange Act rule 18a-7(b), provided that:

(A) The Covered Entity is subject to and complies with the requirements of CRR articles 431 through 455; and HGB sections 316 and 325; and

(B) The Covered Entity applies substituted compliance for the requirements of Exchange Act rule 18a-6(b)(1)(viii) pursuant to this Order.

(iv) The requirements of Exchange Act rule 18a-7(c), (d), (e), (f), (g) and (h) and the requirements of Exchange Act rule 18a-7(j) as applied to the requirements of paragraphs (c), (d), (e), (f), (g) and (h) of Exchange Act rule 18a-7, provided that:

(A) The Covered Entity is subject to and complies with the requirements of CRR articles 26(2), 132(5), 154, 191, 321, 325bi, 350, 353, 368, 418; HGB sections 316 and 325; WpHG section 24 and 84, and 89 (1) sentence 1 no. 1; and KWG section 26a(1);

(B) With respect to financial statements the Covered Entity is required to file annually with the German BaFin, including a report of an independent public accountant covering the financial statements, the Covered Entity:

(1) Simultaneously sends a copy of such annual financial statements and the report of the independent public accountant covering the annual financial statements to the Commission in the manner specified on the Commission's website;

(2) Includes with the transmission the contact information of an individual who can provide further information about the financial statements and report;

(3) Includes with the transmission the report of an independent public accountant required by Exchange Act rule 18a-7(c)(1)(i)(C) covering the annual financial statements if German laws do not require the Covered Entity to engage an independent public accountant to prepare a report covering the annual financial statements; provided, however, that such report of the independent public accountant may be prepared in accordance with generally accepted auditing standards in Germany that the independent public accountant uses to perform audit and attestation services and the accountant complies with German independence requirements;

(4) Includes with the transmission the reports required by Exchange Act rule 18a-7(c)(1)(i)(B) and (C) addressing the statements identified in Exchange Act rule 18a-7(c)(3) or (c)(4), as applicable, that relate to Exchange Act rule 18a-4; provided, however, that the report of the independent public accountant required by Exchange Act rule 18a-7(c)(1)(i)(C) may be prepared in accordance with generally accepted auditing standards in Germany that the independent public accountant uses to perform audit and attestation services and the accountant complies with German independence requirements; and

(5) Includes with the transmission the supporting schedules and reconciliations, as applicable, required by Exchange Act rules 18a-7(c)(2)(ii) and (iii), respectively, relating to Exchange Act rule 18a-2; and

(6) Includes with the transmission the supporting schedules and reconciliations, as applicable, required by Exchange Act rules 18a-7(c)(2)(ii) and (iii), respectively, relating to Exchange Act rules 18a-4 and 18a-4a;

(C) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order; and

(D) The Covered Entity applies substituted compliance for the requirements of Exchange Act rule 18a-6(b)(1)(viii) pursuant to this Order.

(4)(i) *Provide Notification.* The requirements of the following provisions of Exchange Act rule 18a-8, provided that the Covered Entity complies with the relevant conditions in this paragraph (f)(4)(i) and with the applicable conditions in paragraph (f)(4)(ii):

(A) The requirements of paragraphs (a)(1)(i), (a)(1)(ii), (b)(1), (b)(2), and (b)(4) of Exchange Act rule 18a-8 and the requirements of Exchange Act rule 18a-8(h) as applied to the requirements of paragraphs (a)(1)(i), (a)(1)(ii), (b)(1), (b)(2), and (b)(4) of Exchange Act rule 18a-8, provided that:

(1) The Covered Entity is subject to and complies with the requirements of CRR article 366(5); KWG section 25a (1) sentence 6 no. 3; and FinDAG section 4d; and

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(B) The requirements of Exchange Act rule 18a-8(c) and the requirements of Exchange Act rule 18a-8(h) as applied to the requirements of Exchange Act rule 18a-8(c), provided that the Covered Entity is subject to and complies with the requirements of KWG section 25a(1) sentence 6 no. 3; and FinDAG section 4d;

(C) The requirements of Exchange Act rule 18a-8(d) and the requirements of Exchange Act rule 18a-8(h) as applied to the requirements of Exchange Act rule 18a-8(d), provided that:

(1) The Covered Entity is subject to and complies with the requirements of KWG section 25a(1) sentence 6 no. 3; and FinDAG section 4d; and

(2) This Order does not extend to the requirements of Exchange Act rule 18a-8(d) to give notice with respect to books and records required by Exchange Act rule 18a-5 for which the Covered Entity does not apply substituted compliance pursuant to this Order;

(D) The requirements of Exchange Act rule 18a-8(e) and the requirements of Exchange Act rule 18a-8(h) as applied to the requirements of Exchange Act rule 18a-8(e), provided that:

(1) The Covered Entity is subject to and complies with the requirements of KWG section 25a(1) sentence 6 no. 3; and FinDAG section 4d;

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order;

(3) This Order does not extend to the requirements of Exchange act rule 18a-8(e) relating to Exchange Act rule 18a-2 or to the requirements of Exchange Act rule 18a-8(h) as applied to the requirements of Exchange act rule 18a-8(e) relating to Exchange Act rule 18a-2; and

(4) This Order does not extend to the requirements of Exchange act rule 18a-8(e) relating to Exchange Act rule 18a-4 or to the requirements of Exchange Act rule 18a-8(h) as applied to the requirements of Exchange Act rule 18a-8(e) relating to Exchange Act rule 18a-4;

(ii) Paragraph (f)(4)(i) is subject to the following further conditions:

(A) The Covered Entity:

(1) Simultaneously sends a copy of any notice required to be sent by German law cited in this paragraph of the Order to the Commission in the manner specified on the Commission's website; and

(2) Includes with the transmission the contact information of an individual who can provide further information about the matter that is the subject of the notice;

(B) This Order does not extend to the requirements of paragraphs (a)(2) and (b)(3), and of Exchange Act rule 18a-8 relating to Exchange Act rule 18a-2 or to the requirements of Exchange Act rule 18a-8(h) as applied to the requirements of Exchange Act rule 18a-8 relating to Exchange Act rule 18a-2;

(C) This Order does not extend to the requirements or to the requirements of Exchange Act rule 18a-8(h) as applied to the requirements of paragraph (g) of rule 18a-8.

(5) *Securities Counts.* The requirements of Exchange Act rule 18a-9, provided that:

(1) The Covered Entity is subject to and complies with the requirements of EMIR article 11(1)(b); EMIR RTS articles 12 and 13; WpHG section 84; HGB sections 316 and 325; and WpHG section 89 (1) sentence 1 no. 1; and

(2) The Covered Entity applies substituted compliance for the requirements of Exchange Act section 15F(e) and Exchange Act rules 18a-1 through 18a-1d pursuant to this Order.

(6) *Daily Trading Records.* The requirements of Exchange Act section 15F(g), provided that the Covered Entity is subject to and complies with the requirements of WpHG section 83 paragraph 1; and MiFID Org Reg article 21(1)(f), 21(4), and 72(1).

(7) *Examination and Production of Records.* Notwithstanding the forgoing provisions of paragraph (f) of this Order, this Order does not extend to, and Covered Entities remain subject to, the requirement of Exchange Act section 15F(f) to keep books and records open to inspection by

any representative of the Commission and the requirement of Exchange Act rule 18a-6(g) to furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of the Covered Entity that are required to be preserved under Exchange Act rule 18a-6, or any other records of the Covered Entity that are subject to examination or required to be made or maintained pursuant to Exchange Act section 15F that are requested by a representative of the Commission.

(8) *English Translations.* Notwithstanding the forgoing provisions of paragraph (f) of this Order, to the extent documents are not prepared in the English language, Covered Entities must promptly furnish to a representative of the Commission upon request an English translation of any record, report, or notification of the Covered Entity that is required to be made, preserved, filed, or subject to examination pursuant to Exchange Act section 15F of this Order.

**(g) Definitions.**

(1) “Covered Entity” means an entity that:

(i) Is a security-based swap dealer or major security-based swap participant registered with the Commission;

(ii) Is not a “U.S. person,” as that term is defined in rule 3a71-3(a)(4) under the Exchange Act; and

(iii) Is an investment firm and/or credit institution that is authorized by BaFin to provide investment services or perform investment activities in Germany and is supervised by the ECB (or has a licensing application pending with the ECB as of August 12, 2021) as a significant institution.

(2) “MiFID” means the “Markets in Financial Instruments Directive,” Directive 2014/65/EU, as amended from time to time.



(3) “WpHG” means Germany’s “Wertpapierhandelsgesetz”, as amended or superseded from time to time.

(4) “MiFID Org Reg” means Commission Delegated Regulation (EU) 2017/565, as amended from time to time.

(5) “MiFID Delegated Directive” means Commission Delegated Directive (EU) 2017/593, as amended from time to time.

(6) “MLD” means Directive (EU) 2015/849, as amended from time to time.

(7) “GwG” means Germany’s “Geldwäschegesetz,” as amended from time to time.

(8) “MiFIR” means Regulation (EU) 600/2014, as amended from time to time.

(9) “EMIR” means the “European Market Infrastructure Regulation,” Regulation (EU) 648/2012, as amended from time to time.

(10) “EMIR RTS” means Commission Delegated Regulation (EU) 149/2013, as amended from time to time.

(11) “EMIR Margin RTS” means Commission Delegated Regulation (EU) 2016/2251, as amended from time to time.

(12) “CRR Reporting ITS” means Commission Implementing Regulation (EU) 680/2014, as amended from time to time.

(13) “CRD” means Directive 2013/36/EU, as amended from time to time.

(14) “KWG” means Germany’s “Kreditwesengesetz,” as amended from time to time.

(15) “CRR” means Regulation (EU) 575/2013, as amended from time to time.

(16) “MAR” means the “Market Abuse Regulation,” Regulation (EU) 596/2014, as amended from time to time.

(17) “MAR Investment Recommendations Regulation” means Commission Delegated Regulation (EU) 2016/958, as amended from time to time.

(18) “FinDAG” means Germany’s “Finanzdienstleistungsaufsichtsgesetz,” as amended from time to time.

(19) “BaFin” means the Bundesanstalt für Finanzdienstleistungsaufsicht.

(20) “ECB” means the European Central Bank.

(21) “WpDVerOV” means Germany’s “Wertpapierdienstleistungs-Verhaltens- und -Organisationsverordnung,” as amended from time to time.

(22) “SAG” means Germany’s “Sanierungs- und Abwicklungsgesetz,” as amended from time to time.

(23) “SolvV” means Germany’s “Solvabilitätsverordnung,” as amended from time to time.