

Press Release

SEC Adopts Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Amends the Capital and Segregation Requirements for Broker-Dealers

FOR IMMEDIATE RELEASE

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Washington D.C., June 21, 2019 — The Securities and Exchange Commission took another significant step toward establishing the regulatory regime for security-based swap dealers today by adopting a package of rules and rule amendments under Title VII of the Dodd-Frank Act. These and other rules previously adopted by the Commission are designed to enhance the risk mitigation practices of firms that stand at the center of our security-based swap market, thereby protecting their counterparties and reducing risk to the market as a whole.

“I once again would like to thank Commissioner Peirce for her excellent leadership on our efforts to stand up the Dodd-Frank Title VII regulatory regime. Today’s rules reflect another important step in this effort. These rules help ensure that the firms who are at the center of the security-based swap market manage counterparty risk appropriately and in so doing protect investors and the market more generally,” said SEC Chairman Jay Clayton. “Our colleagues at the SEC, including our teams in the Division of Trading and Markets and the Division of Economic and Risk Analysis, brought their extensive knowledge and expertise to bear in crafting these rules. Commissioner Peirce and I are grateful for their efforts and we also want to thank CFTC Chairman Giancarlo, CFTC Commissioner Quintenz, and their colleagues for their efforts and commitments to inter-agency cooperation.”

“These final rules are designed to ensure the financial integrity of dealers at the center of the critically important security-based swap market and represent an enormous effort on the part of our staff, particularly in the Divisions of Trading and Markets and Economic and Risk Analysis,” said Commissioner Hester Peirce. “In addition, working with Commissioner Quintenz and the CFTC on this important rule has been a wonderful opportunity to cooperate in a way that serves the American people. Throughout the process, our two staffs have drawn on one another’s experiences, expertise, and insights in an effort to build effective rules. I am grateful to Chairman Giancarlo and Chairman Clayton for their work on this rule and our broader cooperation efforts.”

Today’s rules address four key areas:

- They establish minimum capital requirements for security-based swap dealers and major security-based swap participants for which there is not a prudential regulator (nonbank SBSBs and MSBSPs). They also increase the minimum net capital requirements for broker-dealers that use internal models to compute net capital (ANC broker-dealers). In addition, they establish capital requirements tailored to security-based swaps and swaps for broker-dealers that are not registered as an SBSB or MSBSP to the extent they trade

these instruments.

- They establish margin requirements for nonbank SBSBs and MSBSPs with respect to non-cleared security-based swaps.
- They establish segregation requirements for SBSBs and stand-alone broker-dealers for cleared and non-cleared security-based swaps.
- They amend the Commission's existing cross-border rule to provide a means to request substituted compliance with respect to the capital and margin requirements for foreign SBSBs and MSBSPs, and provide guidance discussing how the Commission will evaluate requests for substituted compliance.

The accompanying fact sheet describes the rules in more detail.

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FACT SHEET

Final Rules and Amendments

June 21, 2019

The Commission adopted a package of new rules and rule amendments to establish capital, margin, and segregation requirements under Title VII of the Dodd-Frank Act.

Capital Rules for Nonbank SBSBs and Broker-Dealers

The Rules

- Nonbank SBSBs also registered as broker-dealers (other than registered OTC derivatives dealers) will be subject to the pre-existing requirements in the broker-dealer net capital rule (Rule 15c3-1), as amended to account for security-based swap and swap activities of broker-dealers. All other nonbank SBSBs will be subject to capital requirements in new Rule 18a-1. Rule 18a-1 is structured similarly to Rule 15c3-1.

Minimum Capital Requirements

- **Tentative Net Capital.** Nonbank SBSBs that use models to compute net capital and ANC broker-dealers will be subject to minimum tentative net capital requirements (tentative net capital equals net capital before deducting standardized haircuts or, in the case of firms that use models, market and credit risk charges).
- **Net Capital.** Nonbank SBSBs and ANC broker-dealers will be subject to minimum net capital requirements that are the greater of a fixed-dollar amount and an amount equal to 2% of the firm's exposures to its security-based swap customers (2% margin factor) plus, in the case of broker-dealer SBSBs and ANC broker-dealers, the existing ratio-based minimum net capital requirements in Rule 15c3-1 (either the 15-to-1 aggregate indebtedness ratio or the 2% of customer debit items ratio). Nonbank SBSBs that are not broker-dealers (other than an OTC derivatives dealer) will be subject to only a 2% margin factor ratio.
- The following table summarizes the minimum net capital requirements applicable to nonbank SBSBs:

Type of Registrant	Rule

Tentative Net Capital
(Net capital before haircuts)

Net Capital

Fixed-Dollar

Financial Ratio

Stand-alone SBSD (not using internal models)

18a-1

N/A

\$20 million

2% margin factor

Stand-alone SBSD (using internal models)¹

18a-1

\$100 million

\$20 million

2% margin factor

Broker-dealer SBSD
(not using internal models)

15c3-1

N/A

\$20 million

2% margin factor + Rule 15c3-1 ratio

Broker-dealer SBSD (using internal models)

15c3-1

\$5 billion

\$1 billion

2% margin factor + Rule 15c3-1 ratio

¹ Includes a stand-alone SBSD that also is an OTC derivatives dealer.

Computing Net Capital

- **Tailored Deductions and Credit Risk Charges.** The net capital rule requires broker-dealers to deduct 100% of the value of most unsecured receivables when computing net capital because these assets are not readily convertible into cash. The capital rules for nonbank SBSDs also will require that most unsecured receivables be deducted.
- **Unsecured Current Exposure.** Nonbank SBSDs will be required to deduct 100% of the amount of an unsecured receivable arising from electing not to collect variation margin from a counterparty to a non-cleared security-based swap or swap. However, nonbank SBSDs authorized to use internal models and ANC broker-dealers will be permitted to deduct a credit risk charge calculated, in part, based on the creditworthiness of the counterparty rather than take the 100% deduction for an unsecured receivable arising from an OTC derivatives transaction. The new rules establish a cap equal to 10% of the ANC broker-dealer's tentative net capital, which will limit the firm's ability to deduct a credit risk charge rather than taking the 100% deduction. Nonbank SBSDs that are not ANC broker-dealers will not be subject to this cap.
- **Unsecured Potential Future Exposure.** The new capital rules require nonbank SBSDs to deduct 100% of the amount of calculated initial margin for a security-based swap or swap transaction if the firm elects not to collect the initial margin pursuant to an exception in the margin rules of the Commission or the CFTC. However, nonbank SBSDs authorized to use internal models will be able to deduct a credit risk charge rather than take the 100% deduction.
- **Standardized Haircuts.** Nonbank SBSDs and broker-dealers must apply standardized haircuts to proprietary positions if they are not approved to use model-based haircuts. For a cleared security-based swap and swap, the standardized haircut is the applicable clearing agency or derivatives clearing organization margin requirement. For a non-cleared credit default swap (CDS) that is a security-based swap or swap, the standardized haircut will be based on the time to maturity and basis point spread of the CDS. For all other non-cleared security-based swaps or swaps, the standardized haircut generally is the notional amount of

the position multiplied by the standardized haircut that applies to the reference instrument or obligation (e.g., the standardized haircut for an exchange traded equity security is 15% thus the standardized haircut for a security based-swap referencing an exchange traded equity security is 15% multiplied by the notional amount of the security-based swap).

- **Model-Based Haircuts.** ANC broker-dealers and OTC derivatives dealers are allowed to use model-based haircuts instead of applying the standardized haircuts. Their use of models must be approved by the Commission. The models are subject to quantitative and qualitative requirements and the firms' use of, and governance over, the models is subject to on-going oversight. Nonbank SBSBs will be permitted to use models subject to the same requirements and oversight.

Internal Risk Management Controls

- Nonbank SBSBs must comply with Rule 15c3-4 which will require them to establish, document, and maintain a system of internal risk management controls.

Capital Rules for Nonbank MSBSPs

- Rule 18a-2 will require nonbank MSBSPs to have and maintain at all times positive tangible net worth and to comply with Rule 15c3-4 with respect to their security-based swap and swap activities.

Margin Requirements for Nonbank SBSBs

Calculation

- **Daily Calculation.** Rule 18a-3 will require a nonbank SBSB to calculate with respect to each account of a counterparty as of the close of business each day: (1) the amount of current exposure in the account (i.e., variation margin) and (2) the initial margin amount for the account. Variation margin will be calculated by marking the position to market. Initial margin will be calculated by applying standardized haircuts or a margin model.
- **Model Approval and Oversight.** A nonbank SBSB may apply to the Commission for authorization to use a model (including an industry standard model) to calculate initial margin. The models are subject to quantitative and qualitative requirements and the firms' use of, and governance over, the models is subject to on-going oversight.
- **Limits on Using a Model.** Broker-dealer SBSBs must use the standardized haircuts for security-based swaps referencing equity securities and indexes. This limit is designed to maintain parity with the margin rules for cash market equity positions (e.g., exchange traded equity securities and listed options). Broker-dealer SBSBs can use a margin model for other types of security-based swaps (e.g., CDS). Nonbank SBSBs may use a model to calculate initial margin for all types of security-based swaps. However, with respect to security-based swaps referencing equity securities or indexes, the model can be used only if the account holds no other type of equity securities.

Collecting Collateral

- A nonbank SBSB will need to collect initial margin and/or variation margin from a counterparty if the margin calculations result in a requirement for the counterparty to post margin. A nonbank SBSB will need to deliver variation margin if the margin calculations result in a requirement to post variation margin. The rule will not require a nonbank SBSB to post initial margin to counterparties (though it does not prohibit this practice if the parties agree to exchange initial margin).
- Margin collateral, among other things, will need to have a "ready market" and consist of cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared security-

based swap, or gold. A nonbank SBSD must “haircut” collateral using the standardized haircuts in the Commission’s net capital rules or the CFTC’s margin rules.

Exceptions

- Rule 18a-3 has exceptions under which a nonbank SBSD need not collect variation and/or initial margin nor deliver variation margin under certain circumstances. The following table illustrates the types of counterparties or transactions that are subject to exceptions in the rule.

Exception
Status of Exceptions to Collecting Margin
Status of Exceptions to Delivering VM

VM
IM

Commercial End User
Need Not Collect
Need Not Collect
Need Not Deliver

BIS or European Stability Mechanism
Need Not Collect
Need Not Collect
Need Not Deliver

Multilateral Development Bank

Need Not Collect

Need Not Collect

Need Not Deliver

Financial Market Intermediary

Must Collect

Need Not Collect

Must Deliver

Affiliate

Must Collect

Need Not Collect

Must Deliver

Sovereign with Minimal Credit Risk

Must Collect

Need Not Collect

Must Deliver

Legacy Account

Need Not Collect

Need Not Collect

Need Not Deliver

IM Below \$50 Million Threshold

Must Collect

Need Not Collect

Must Deliver

Minimum Transfer Amount

Need Not Collect

Need Not Collect

Need Not Deliver

Margin Requirements for Nonbank MSBSPs

- Rule 18a-3 will require a nonbank MSBSP to collect collateral from or deliver collateral to a counterparty to cover a variation margin requirement, unless an exception applies. The rule does not require these entities to collect or deliver initial margin.

Segregation Requirements for Broker-Dealers and SBSDs

The Rules

- The segregation requirements for broker-dealers and broker-dealer SBSDs (other than firms registered as OTC derivatives dealers) are codified in amendments to Rule 15c3-3. The segregation requirements for all other SBSDs (including firms that have no other registration, are registered as OTC derivatives dealers, or are bank SBSDs) are codified in Rule 18a-4.

Omnibus Segregation Requirements

- The segregation rules will require an SBSD or broker-dealer to segregate money, securities, and property of a security-based swap customer relating to a cleared or non-cleared security-based swap, but to do so in a

manner that permits the assets to be commingled with money, securities, or property of other customers (omnibus segregation).

- The omnibus segregation requirements are mandatory with respect to money, securities, or other property held by an SBSB or broker-dealer relating to a cleared security-based swap (i.e., customers cannot waive segregation). With respect to non-cleared security-based swap transactions, the omnibus segregation requirements are an alternative to the statutory provisions pursuant to which a counterparty can elect to have initial margin individually segregated or to waive segregation. However, under the final omnibus segregation rules for stand-alone broker-dealers and broker-dealer SBSBs, counterparties that are not an affiliate of the firm cannot waive segregation.
- Under the omnibus segregation requirements, an SBSB or broker-dealer must maintain: (1) possession or control over excess securities collateral (i.e., securities and money market instruments that are not being used to meet a variation margin requirement of the counterparty); and (2) a security-based swap customer reserve account to segregate cash and/or qualified securities in an amount equal to the net cash owed to security-based swap customers, calculated on a weekly basis.

Exemption from the Segregation Requirements

- SBSBs that are not broker-dealers (other than OTC derivatives dealers) will be exempt from the requirements of Rule 18a-4 if the firm does not clear security-based swap transactions for other persons and meets certain other conditions.

Alternative Compliance Mechanism

- Rule 18a-10 provides that an SBSB that is not a broker-dealer and is registered as a swap dealer and predominantly engages in a swaps business may elect to comply with the capital, margin, and segregation requirements of the Commodity Exchange Act and the CFTC's rules instead of complying with the capital, margin, and segregation rules of the Commission if certain conditions are met.

Cross-Border Application

- Foreign SBSBs and MSBSPs may be able to avail themselves of substituted compliance to satisfy the capital and margin requirements. Rule 18a-4 (but not Rule 15c3-3) contains exceptions pursuant to which foreign SBSBs subject to its requirements need not comply with the segregation requirements for certain transactions.

What's Next?

The rules will become effective 60 days after publication in the Federal Register. The compliance date for the rule amendments and new rules is 18 months after the later of: (1) the effective date of the final rules establishing recordkeeping and reporting requirements for SBSBs and MSBSPs; or (2) the effective date of the final rules addressing the cross-border application of certain security-based swap requirements.

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Related Materials

- Final Rule