
The SEC Adopts Security-Based Swap Rules Governing Capital, Margin and Segregation

JULY 22, 2019

I. Introduction

On June 21, 2019, the Securities and Exchange Commission (SEC or Commission) adopted a package of rules and rule amendments (Rules) that set forth the capital, margin and segregation requirements for security-based swap dealers (SBSDs) and major security-based swap participants (MSBSPs). As discussed below, these rules establish capital and margin requirements for nonbank SBSDs and segregation requirements for SBSDs.

The Rules will go into effect 60 days after publication in the *Federal Register*. The compliance date for the Rules, however, is 18 months after the later of (1) the effective date of the final rules establishing recordkeeping and reporting requirements for SBSDs or (2) the effective date of the final rules addressing the cross-border application of security-based swap requirements.

II. Capital Rules for Nonbank SBSDs and MSBSPs

The Commission has adopted capital requirements for nonbank SBSDs and MSBSPs by amending Rule 15c3-1 and adopting Rules 18a-1 and 18a-2. The capital requirements addressed in the amendments to Rule 15c3-1 apply to broker-dealers, including broker-dealers registered as SBSDs. The capital requirements noted in Rule 18a-1 apply to stand-alone SBSDs, including stand-alone SBSDs that are also registered as over-the-counter (OTC) derivatives dealers. Finally, the capital requirements provided in Rule 18a-2 apply to nonbank MSBSPs. Below is a summary of the capital requirements for each of these entities.

A. Broker-Dealers, Including Broker-Dealers Registered as SBSDs

Rule 15c3-1 requires a broker-dealer to maintain a minimum level of net capital. Under the amendments to Rule 15c3-1, the minimum level of net capital imposed on a broker-dealer is dependent on whether the SEC has authorized the broker-dealer to use internal models to compute net capital or whether the broker-dealer is using standardized haircuts. The SEC “believes that most nonbank SBSDs will seek approval to use model-based haircuts.”¹ A broker-dealer must apply to the Commission for authorization in order to use models to compute haircuts and credit risk charges.² The Commission, in fact, encourages firms to notify the “Commission staff as early as

possible in advance of the registration compliance date to begin the model approval process.”³

Pursuant to the amendments to Rule 15c3-1, broker-dealers, including broker-dealer SBSDs, authorized to use internal models must maintain a tentative net capital⁴ of not less than \$5 billion.⁵ In addition, these broker-dealers are required to maintain a net capital of not less than the greater of \$1 billion or the amount of the 15-to-1 ratio or 2% debit item ratio plus an amount equal to 2% of an amount determined by calculating the firm’s exposure to its security-based swap customers (2% margin factor).⁶ Broker-dealers authorized to use models also will be required to provide the Commission with an “early warning” notice when their tentative net capital falls below \$6 billion.⁷

Pursuant to the amendments to Rule 15c3-1, broker-dealers, including broker-dealer SBSDs, not authorized to use internal models must maintain net capital of not less than the greater of \$20 million or the amount of the 15-to-1 ratio or 2% debit item ratio plus the 2% margin factor.⁸ However, these broker-dealers will not be subject to a fixed-dollar tentative net capital requirement.

B. Stand-Alone SBSDs

Rule 18a-1 will require stand-alone SBSDs to maintain a minimum level of net capital. Like broker-dealer SBSDs, a stand-alone SBSD’s minimum level of net capital depends on whether it is authorized to use internal models to compute net capital. The stand-alone SBSDs authorized to use internal models, must maintain a minimum tentative net capital of not less than \$100 million.⁹ Stand-alone SBSDs need Commission authorization to apply model-based haircuts.¹⁰ In addition, stand-alone SBSDs authorized to use internal models will be required to maintain net capital of not less than the greater of \$20 million or the 2% margin factor.¹¹ On the other hand, stand-alone SBSDs not authorized to use internal models will not be subject to a fixed-dollar tentative net capital requirement. These SBSDs must maintain a minimum net capital of not less than the greater of \$20 million or the 2% margin factor.¹² OTC derivatives dealers that also register as SBSDs are subject to Rule 18a-1 and its schedules, rather than Rule 15c3-1 and its schedules.

C. MSBSPs

Rule 18a-2 provides the capital requirements for nonbank MSBSPs. Specifically, the rule provides that nonbank MSBSPs will always be required to have and maintain positive tangible net worth.¹³

D. Computing Net Capital

In computing net capital, nonbank SBSDs and stand-alone broker-dealers must determine their net worth using US generally accepted accounting principles (GAAP). These entities would then need to adjust their net worth, including by deducting illiquid assets. Some of the adjustments that a nonbank SBSD and a stand-alone broker-dealer will be required to make to their net worth appear below.

1. Deduction for Posting Initial Margin

A stand-alone broker-dealer or nonbank SBSD that delivers initial margin to a counterparty is generally required to take a deduction from net worth in the amount of the posted collateral. The Commission provided exceptions to this rule. A stand-alone broker-dealer or nonbank SBSD that

provides initial margin to a counterparty does not need to deduct from net worth when computing net capital if: (1) the initial margin requirement is funded by the stand-alone broker-dealer's or nonbank SBSD's affiliate pursuant to a fully executed written loan agreement; (2) the loan agreement notes the lender waives repayment of the loan until the initial margin is returned to the stand-alone broker-dealer or nonbank SBSD; and (3) the stand-alone broker-dealer's or the nonbank SBSD's liability to the lender can be fully satisfied by delivering the collateral serving as initial margin to the lender.¹⁴

2. Deduction for Not Collecting Margin

Stand-alone broker-dealers and nonbank SBSDs will be required to take a deduction for failing to collect margin for under-margined accounts as required by Rule 15c3-1(c)(2) and Rule 18a-1(c)(1). With respect to non-cleared security-based swaps, nonbank SBSDs will be required to deduct from net worth when computing net capital unsecured receivables, including receivables occurring from not collecting variation margin under an exception in the margin rule.¹⁵ Nonbank SBSDs also will be required "to deduct the initial margin amount for non-cleared security-based swaps calculated under Rule 18a-3 with respect to a counterparty or account, less the margin value of collateral held in the account."¹⁶ If the nonbank SBSD does not collect and hold variation or initial margin for an account pursuant to one of the exceptions in Rule 18a-3, the nonbank SBSD will then be required to take a 100% deduction for the uncollateralized amount of the exposure. The amount of the exposure for uncollected variation margin is the mark-to-market value of the security-based swap. The amount of the exposure for the initial margin is the initial margin amount calculated pursuant to Rule 18a-3. However, both broker-dealer SBSDs and stand-alone SBSDs authorized to use internal models can apply a credit risk model to these exposures instead of taking these deductions.¹⁷

With respect to swaps, a nonbank SBSD will be required to deduct unsecured receivables from net worth when computing net capital, including receivables arising from not collecting variation margin under an exception in the non-cleared swaps margin rules of the CFTC. The final rules also will require "a nonbank SBSD to deduct initial margin amounts calculated pursuant to the margin rules of the CFTC, less the margin value of collateral held in the account of a swap counterparty at the SBSD."¹⁸ If a nonbank SBSD does not collect and hold variation or initial margin for an account pursuant to an exception in the CFTC's margin rules, the nonbank SBSD will be required to take a 100% deduction for the uncollateralized amount of the exposure. The amount of the exposure for uncollected variation margin is the mark-to-market value of the swap. The amount of the exposure for uncollected initial margin is the initial margin amount calculated pursuant to the CFTC's margin rules. However, a broker-dealer authorized to use internal models and nonbank SBSDs authorized to use internal models can apply a credit risk model to these exposures instead of taking these deductions.¹⁹

The Rules do provide some flexibility. For example, Rule 18a-1 provides that a nonbank SBSD or MSBSP may have an additional day to collect required margin from a counterparty if the counterparty is in a different country and more than four time zones away. Additionally, the deduction for uncollected margin can be reduced by calls for margin, marks to market or other required deposits that are outstanding within the required time frame to collect the margin, mark to market or other required deposits.²⁰ In addition, the margin may be held by a third-party custodian under certain

conditions. The third-party custodian may be a bank, a clearing organization registered with the SEC or CFTC, or a foreign bank or clearing organization for foreign securities or foreign currency collateral.²¹ The third-party custodian may be an affiliate of the nonbank SBSD but not an affiliate of the counterparty. The SBSD must “analyze whether the custodial agreement will provide the SBSD, as the secured party, with the right to access the collateral.”²² The SEC also is permitting a deduction in lieu of margin for legacy accounts.²³

3. Standardized Haircuts

The Commission has adopted standardized haircuts tailored to security-based swaps and swaps for nonbank SBSDs that do not use models. With respect to cleared security-based swaps and swaps, the amount of the deduction will be the amount of margin required by the applicable clearing agency or the derivatives clearing organization (DCO) where the position is cleared.²⁴ The Commission noted, however, that as an alternative, a stand-alone broker-dealer and a nonbank SBSD can use the methodologies described in Rule 15c3-1a and Rule 18a-1a to derive a portfolio-based standardized haircut for cleared security-based swaps that reference an equity security or narrow-based equity index and swaps that reference a broad-based equity index.²⁵

With respect to non-cleared interest rate swaps, the standardized haircuts are determined by using the maturity grid for US government securities as described in Rule 15c3-1(c)(2)(vi)(A) and Rule 18a-1a.²⁶ With respect to non-cleared credit default swaps (CDS), the standardized haircut is laid out in “two grids (one for security-based swaps and one for swaps) in which the amount of the deduction is based on two variables: the length of time to maturity of the CDS contract and the amount of the current offered basis point spread on the CDS.”²⁷ For non-cleared security based-swaps and swaps that are not CDS or interest-rate swaps, the haircut is the notional value of the security based-swap or swap multiplied by the percentage specified in Rule 15c3-1 or in Rule 1.17, the CFTC’s capital rule for futures commission merchants (FCMs), for the underlying asset.²⁸ Stand-alone broker-dealers and nonbank SBSDs will be permitted to reduce this deduction by an amount equal to any reduction recognized for a comparable long or short position in the reference security under the standardized haircuts in Rule 15c3-1 and Rule 18a-1.²⁹

4. Credit Risk Models

Rules 15c3-1 and 18a-1 permit both broker-dealers and stand-alone SBSDs authorized to use internal models to apply credit risk models to credit exposures arising from all derivatives transactions. Specifically, credit risk models can be applied to uncollateralized current exposures to counterparties stemming from derivatives instruments, including exposures occurring from not collecting variation margin from counterparties pursuant to exceptions in the margin rules of the Commission and the CFTC.³⁰ Rule 15c3-1 and Rule 18a-1 also allow broker-dealers and stand-alone SBSDs authorized to use internal models to utilize credit risk models instead of taking the 100% deductions to net worth for choosing not to collect initial margin for non-cleared security-based swaps and swaps pursuant to exceptions in the margin rules of the Commission and the CFTC, respectively.³¹

Broker-dealers authorized to use internal models, including broker-dealer SBSDs that apply credit

risk models, will be subject to a portfolio concentration charge equal to 100% of the firm's aggregate current exposure to all counterparties in excess of 10% of the firm's tentative net capital.³² Therefore, any unsecured receivables resulting from the broker-dealers not collecting variation margin are included in the portfolio concentration charge. The charge does not include potential future exposure arising from electing not to collect initial margin. On the other hand, stand-alone SBSDs, including stand-alone SBSDs that are registered as OTC derivatives dealers, will not be subject to a portfolio concentration charge.³³

E. Other Key Provisions

Nonbank SBSDs will be required to comply with Rule 15c3-4 and establish, document and maintain internal risk management controls. These risk management controls will assist in managing the risks associated with a nonbank SBSD's business activities, including market, credit, leverage, liquidity, legal and operational risks.³⁴ MSBSPs also must establish and maintain a strong risk management control system that complies with Rule 15c3-4.³⁵

Nonbank SBSDs also will be required to provide notice when they seek to withdraw capital in an amount that exceeds certain thresholds. The Commission is permitted to issue an order temporarily restricting nonbank SBSDs from withdrawing capital or making loans or advances to stockholders, insiders and affiliates under certain circumstances.³⁶

Additionally, nonbank SBSDs will be required to take a capital charge for short securities differences that are unresolved for seven days or longer and for long securities differences where the securities have been sold before they are adequately resolved.³⁷

Nonbank SBSDs will be permitted to increase their net capital with subordinated loans, subject to the debt-to-equity ratio limits designed to ensure that nonbank SBSDs have a base of permanent capital in addition to any subordinated loans.³⁸

III. Margin Requirements

Rule 18a-3 will require nonbank SBSDs to calculate margin with respect to non-cleared security-based swaps. The rule requires a nonbank SBSD 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 of the counterparty, or variation margin (VM), and (2) the initial margin (IM) for the account of the counterparty.³⁹ VM is calculated by marking the position to market.⁴⁰ IM must be calculated by applying the standardized haircuts prescribed in Rule 15c3-1 or model-based haircuts approved by the SEC.⁴¹ Stand-alone SBSDs (including firms registered as OTC derivatives dealers) may use a model to calculate initial margin for non-cleared equity security-based swaps (and potentially equity swaps if portfolio margining is implemented by the SEC and CFTC),⁴² provided the account of the counterparty does not hold equity security positions other than equity security-based swaps (and potentially equity swaps).⁴³

The final rules provide that SBSDs will have until the end of the next business day to collect margin and an additional day if the counterparty is located in another country and more than four time zones away.⁴⁴ The final rules expand eligible margin collateral to include cash, securities, money market

instruments, a major foreign currency, the settlement currency of the non-cleared security-based swap and gold.⁴⁵ However, the rule specifically excludes collateral issued by the SBSD, its counterparty or a “party related to” either such entity.⁴⁶ In addition, collateral being used to meet the margin requirement must meet conditions specified in the Rules, including that it must have a ready market and be readily transferable.⁴⁷ Haircuts on collateral are specified in the relevant capital rule for the SBSD, except that an SBSD can apply the haircuts specified under the CFTC margin requirements so long as the SBSD applied those deductions consistently with respect to a particular counterparty. This consistency requirement is designed to prevent a nonbank SBSD from “cherry picking” either the nonbank SBSD capital haircuts or the CFTC haircuts at different points in time depending on which set provides the more advantageous haircut.⁴⁸

The margin collection requirements apply to all counterparties of a broker-dealer or SBSD, except no VM or IM need be collected from (1) commercial end users that may rely on an exception from mandatory clearing and (2) certain specified supra national entities.⁴⁹ Similarly, a nonbank SBSD need not collect IM or VM with respect to a legacy account (i.e., an account holding security-based swaps entered into prior to the compliance date of the Rules). Further, a nonbank SBSD is not required to collect IM from a counterparty that is a sovereign entity if the nonbank SBSD has determined that the counterparty has only a minimal amount of credit risk.

Margin collection requirements in the final rules for interdealer transactions differ from the prudential regulators’ rules. Under the SEC’s final margin rules, nonbank SBSDs are not required to collect IM from financial market intermediaries, including other SBSDs.⁵⁰ In contrast, under the prudential regulators’ rules, covered entities, including SBSDs, are required to exchange IM on interdealer transactions. Under the SEC’s final rules, a nonbank SBSD also need not hold IM directly if the counterparty delivers the IM to an independent third-party custodian. The prudential regulators’ rules require covered entities to segregate the IM at an independent third-party custodian. The SEC’s final rules, however, do require nonbank SBSDs to take capital deductions in lieu of margin or credit risk charges with respect to uncollateralized potential future exposure.⁵¹

The SEC’s final rules include a threshold exception to the IM requirement. Under this exception, a nonbank SBSD is not required to collect IM to the extent that the IM amount when aggregated with other security-based swap and swap exposures of the nonbank SBSD and its affiliates to the counterparty and its affiliates does not exceed \$50 million.⁵² The final rules permit a nonbank SBSD to defer collecting IM from a counterparty for two months after the month in which the counterparty does not qualify for the \$50 million threshold exception for the first time.⁵³ Finally, the rules have a minimum transfer amount exception of \$500,000. Under this exception, if the combined amount of margin required to be collected from or delivered to a counterparty is equal to or less than \$500,000, the nonbank SBSDs need not collect or deliver the margin. If the IM or VM requirements collectively or individually exceed \$500,000, collateral equal to the full amount of the margin requirement must be collected or delivered.⁵⁴

Following the final rulemaking, SEC Chair Jay Clayton and CFTC Chair J. Christopher Giancarlo stated their intention to explore whether portfolio margining would be an area where SEC-CFTC “harmonization” would be beneficial.⁵⁵ In the joint statement, Messrs. Clayton and Giancarlo stated

they were committed to working together to ensure the agencies' regulations are effective, consistent, mutually reinforcing and efficient, by (1) assessing the portfolio margining of uncleared CFTC-regulated swaps with SEC-regulated security-based swaps, (2) expanding joint portfolio margining of cleared swaps and security-based swaps, and (3) expanding portfolio margining to futures and cash equity positions.

IV. Segregation Requirements

The Commission has adopted security-based swap segregation requirements for SBSDs, including bank SBSDs, and stand-alone broker-dealers pursuant to Rules 15c3-3 and 15c3-3b and Rules 18a-4 and 18a-4a for cleared and non-cleared security-based swaps.⁵⁶ These rules generally provide that money, securities and property of a security-based swap customer relating to both cleared and non-cleared security-based swaps must be segregated and must not be commingled with the funds of a broker-dealer or an SBSD (known as “omnibus segregation”). The property could, however, be commingled with the money, securities or property of other customers.⁵⁷

A customer cannot waive segregation with respect to money, securities or other property relating to cleared security-based swaps that are held by a stand-alone broker-dealer or SBSD. For non-cleared security-based swap transactions, a counterparty can choose to waive segregation or choose to have IM individually segregated.⁵⁸ However, for stand-alone broker-dealers and broker-dealer SBSDs, Rule 15c3-3 does not permit counterparties that are not affiliated with the firm to waive segregation. Affiliated counterparties of a stand-alone broker-dealer or broker-dealer SBSDs can waive segregation.⁵⁹ On the other hand, with respect to stand-alone SBSDs or bank SBSDs, Rule 18a-4 allows all counterparties, regardless of whether affiliated or non-affiliated to the stand-alone SBSD or bank SBSD, to waive segregation with respect to non-cleared security-based swap transactions.⁶⁰

An SBSD or stand-alone broker-dealer is generally required to maintain possession or control over excess securities collateral carried for the accounts of security-based swap customers.⁶¹ There are two exceptions to this requirement. Excess securities collateral can be held in a manner that is not in the possession or control of the SBSD or stand-alone broker-dealer if the collateral is being used (1) to satisfy a margin requirement of a clearing agency resulting from a cleared security-based swap transaction of the security-based swap customer, or (2) “to meet a margin requirement of an SBSD resulting from the first SBSD or stand-alone broker-dealer entering into a non-cleared security-based swap transaction with the SBSD to offset the risk of a non-cleared security-based swap transaction between the first SBSD or broker-dealer and the security-based swap customer.”⁶²

Excluded from the definition of excess securities collateral are securities held in a “third-party custodial account.”⁶³ “Third-party custodial account” means, among other conditions, an account carried by a bank as defined in Section 3(a)(6) of the Exchange Act or a registered US clearing organization or depository, or, if the collateral to be held in the account consists of foreign securities or currencies, a supervised foreign bank, clearing organization or depository that customarily maintains custody of such foreign securities or currencies.⁶⁴

SBSDs and stand-alone broker-dealers will be required to maintain a security-based swap customer reserve account in order to segregate cash and qualified securities.⁶⁵ The customer reserve account must be equal to the net cash owed to security-based swap customers. SBSDs and stand-alone broker-dealers also will be required at all times to maintain, through deposits into the account, cash or qualified securities in amounts required to be computed weekly.⁶⁶ With respect to a broker-dealer SBSD or stand-alone broker-dealer, the customer reserve account must be separate from the reserve accounts the firm maintains for “traditional” securities customers and other broker-dealers under the pre-existing requirements of Rule 15c3-3.⁶⁷

Stand-alone and bank SBSDs will be exempt from the requirements of Rule 18a-4 if they meet certain conditions, including that the stand-alone and bank SBSDs (1) do not clear security-based swap transactions for other persons, (2) provide notice to the counterparty in regard to the right to segregate IM at an independent third-party custodian, (3) disclose in writing to the counterparty that any collateral received by the SBSD will not be subject to a segregation requirement with respect to non-cleared security-based swaps, and (4) disclose to the counterparty in writing regarding how a claim of the counterparty for the collateral would be treated in a bankruptcy or other formal liquidation proceeding of the SBSD.⁶⁸ The SEC stated that it expects bank SBSDs to operate under this exemption, because in order to clear swaps for other persons, SBSDs would need to be registered as FCMs, which would subject them to CFTC capital requirements.⁶⁹

MSBSPs do not have omnibus segregation requirements.⁷⁰ However, a counterparty can request that collateral be held at a third-party custodian if an MSBSP requires IM from that counterparty with respect to non-cleared security-based swaps.⁷¹

V. SBSD Predominantly Engaged in Swaps Business

A stand-alone SBSD that is registered as a swap dealer with the CFTC and predominately engages in a swaps business may elect to comply with the capital, margin and segregation requirements of the CEA and CFTC.⁷² In order to qualify to operate pursuant to Exchange Act Rule 18a-10, the stand-alone SBSD cannot be registered as a broker-dealer or an OTC derivatives dealer. Moreover, in addition to other conditions, the aggregate gross notional amount of the firm’s security-based swap positions must not exceed the lesser of a maximum fixed-dollar amount or 10% of the combined aggregate gross notional amount of the firm’s security-based swap and swap positions. The maximum fixed-dollar amount is set at a transitional level of \$250 billion for the first three years after the compliance date of the Rules and then drops to \$50 billion thereafter unless the SEC issues an order (1) maintaining the \$250 billion maximum fixed-dollar amount for an additional period of time or indefinitely, or (2) lowering the maximum fixed-dollar amount to an amount between \$250 billion and \$50 billion.

VI. Cross-Border Application of Capital, Margin and Segregation Requirements

A. Capital and Margin Requirements

The Commission will consider the new capital and margin requirements as entity-level requirements⁷³ that apply to the entirety of the SBSD’s and MSBSP’s business. Additionally, the

Commission amended Rule 3a71-6, making the capital and margin requirements available to foreign SBSDs and MSBSPs for substituted compliance determinations. Specifically, Rule 3a71-6(a)(2)(i) provides that the Commission will consider in its substituted compliance determination factors such as:

the scope and objectives of the relevant foreign regulatory requirements, as well as the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by a foreign financial regulatory authority or authorities in such system to support its oversight of such foreign security-based swap entity or of the activities of such security-based swap entity.⁷⁴

The Commission also may conduct a comparability analysis with respect to the capital and margin requirements. In conducting that comparability analysis, the Commission may use in conjunction the comparability analyses of other Exchange Act requirements that promote risk management in connection with SBSDs and MSBSPs. As such, “the comparability assessment associated with the capital and margin requirements may constitute part of a broader assessment of the foreign regulatory system’s risk mitigation requirements, and the applicable comparability assessments may be conducted at the level of those risk mitigation requirements as a whole.”⁷⁵

B. Segregation Requirements

Unlike the capital and margin requirements, the segregation requirements are deemed transaction-level requirements, and substituted compliance is not available for them. Specifically, Rule 18a-4 provides that the segregation requirements of Section 3E of the Exchange Act, and the rules and regulations thereunder, apply to a foreign bank SBSD⁷⁶ regarding a security-based swap customer that is a US person, and apply to a security-based swap customer that is not a US person if the foreign bank SBSD holds funds or other property arising out of a transaction had by such person with a US branch or agency of the foreign SBSD.⁷⁷

Rule 18a-4 will require a foreign stand-alone SBSD that is not a broker-dealer and is not a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union to follow the segregation requirements of Section 3E of the Exchange Act, and the rules and regulations thereunder, regarding the assets received from both US and non-US persons if the foreign stand-alone SBSD received collateral from at least one US person to secure cleared security-based swaps.⁷⁸

The omnibus segregation requirements of Rule 18a-4 do not apply to MSBSPs. An MSBSP will, however, be required to provide notice of the counterparty’s right to require segregation if it holds collateral for a security-based swap.⁷⁹ An MSBSP also will be required, if requested by a security-based swap customer, to separately segregate the funds or other property for the benefit of the security-based swap customer.⁸⁰

VII. Conclusion

The Commission has made significant changes impacting the security-based swap industry by amending its existing rules and adopting new Rules under Title VII of the Dodd-Frank Act.

Specifically, the Commission has amended its existing rules and adopted new Rules establishing the capital and margin requirements for nonbank SBSDs, including broker-dealer SBSDs, broker-dealer MSBSPs, stand-alone SBSDs and stand-alone MSBSPs. The Commission also has amended existing rules and adopted new Rules to establish the segregation requirements for SBSDs and notification requirements with respect to segregation for SBSDs and MSBSPs. The Commission also has amended its existing cross-border rule, providing an avenue to seek substituted compliance with respect to the capital and margin requirements for foreign nonbank SBSDs and MSBSPs and providing guidance on how it will evaluate requests for substituted compliance. Finally, the Commission has adopted rule-based requirements that address the application of the segregation requirements to cross-border security-based swap transactions. The compliance date for the rule amendments and new Rules will be 18 months after the later of (1) the effective date of the final rules establishing recordkeeping and reporting requirements for SBSDs and MSBSPs or (2) the effective date of the final rules addressing the cross-border application of certain security-based swap requirements.

It is not clear, however, how many entities will be affected by much of this rulemaking, given that (1) much of this rulemaking applies only to SBSDs not regulated by a prudential regulator, (2) foreign SBSDs have the availability of substituted compliance, and (3) there are exceptions for SBSDs predominantly engaged in a swaps business.

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1. Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, SEC Release No. 34-86175 at 90 (Jun. 21, 2019).
 2. Nonbank SBSDs and stand-alone broker-dealers must submit an alternative net capital (ANC) application to the Commission seeking authorization to use model-based haircuts. As part of the review process, the Commission staff reviews the operation of the nonbank SBSD's or stand-alone broker-dealer's model, including reviewing the associated risk management controls and the use of stress tests, scenario analyses and back-testing. The nonbank SBSD or stand-alone broker-dealer provides this information in order to demonstrate to the Commission staff that the "model reliably accounts for the risks that are specific to the types of positions the firm intends to include in the model computations." The Commission staff then assesses "the quality, rigor, and adequacy of the technical components of the model and of related governance processes around the use of the model as well as the firm's risk management policies, procedures, and controls." SEC Release No. 34-86175 at 97-8.
 3. The Commission will permit the use of a provisional model if the provisional model has been approved by a prudential regulator, the Commodities Futures Trading Commission (CFTC), a CFTC-registered futures association, a foreign financial regulatory authority that administers capital and/or margin requirements that the Commission has found are eligible for substituted compliance, or any other foreign supervisory authority that the Commission finds has approved and monitored the use of the provisional model through a process comparable to the process set forth in the final rules. See SEC Release No. 34-86175 at 105-06.

4. Tentative net capital is defined as the “amount of net capital maintained by nonbank SBSB before deducting haircuts (standardized or model-based) with respect to the firm’s proprietary positions and, for firms authorized to use models, before deducting the credit risk charges.” *Id.* at 41.
5. *See* Exchange Act Rule 15c3-1(a)(7)(i).
6. The 2% margin factor multiplier will remain 2% for at least three years after the compliance date of the rule. After three years, the Commission could, by Commission order, increase the 2% margin factor multiplier to not more than 4%. After five years, the Commission could increase the margin factor multiplier to not more than 8% by Commission order if the Commission previously issued an order raising the margin factor multiplier to 4% or less. Before the Commission can issue an order to raise the margin factor multiplier, the Commission will need to consider the capital and leverage levels of the firms subject to the ratio-based minimum net capital requirements as well as the risk of their security-based swap positions. *See* Rule 15c3-1(a)(7)(i); *see also* SEC Release No. 34-86175 at 47-8.
7. *See* Exchange Act Rule 15c3-1(a)(7)(ii).
8. *See* Exchange Act Rule 15c3-1(a)(10)(i).
9. *See* Exchange Act Rule 18a-1(a)(2).
10. SEC Release No. 34-86175 at 96.
11. *Id.*
12. *See* Exchange Act Rule 18a-1(a)(1).
13. “Tangible net worth” means the nonbank MSBSP’s net worth as determined in accordance with GAAP, excluding goodwill and other intangible assets. The definition allows nonbank MSBSPs to include as regulatory capital those assets that would be deducted from net worth under Rule 15c3-1, such as property, plant, equipment and unsecured receivables. The definition also would require the deduction of goodwill and other intangible assets. SEC Release No. 34-86175 at 125.
14. SEC Release No. 34-86175 at 56.
15. Exchange Act Rule 15c3-1(c)(2)(iv); Exchange Act Rule 18a-1(c)(1)(iii).
16. Exchange Act Rule 15c3-1(c)(2)(xv)(A); Exchange Act Rule 18a-1(c)(1)(ix)(A); *see also* SEC Release No. 34-86175 at 71.
17. SEC Release No. 34-86175 at 71-2.
18. Exchange Act Rule 15c3-1(c)(2)(iv); Exchange Act Rule 18a-1.
19. SEC Release No. 34-86175 at 72.
20. *Id.* at 63.

21. *Id.* at 76-7.
22. *Id.* at 81.
23. *Id.* at 82.
24. *Id.* at 91.
25. *Id.* at 92-3.
26. *Id.* at 93.
27. *Id.* at 410.
28. Exchange Act Rule 15c3-1b(b)(2)(ii)(A)(3); Exchange Act Rule 18a-1b(b)(2)(ii)(A)(3); SEC Release No. 34-86175 at 93; 17 C.F.R. § 1.17.
29. *Id.* at 93.
30. SEC Release No. 34-86175 at 112.
31. *Id.*
32. *Id.* at 113.
33. *Id.* at 115.
34. Exchange Act Rule 15c3-4; *see also* SEC Release No. 34-86175 at 120-21.
35. *See* Rule 18a-2(c); *see also* SEC Release No. 34-86175 at 129.
36. Exchange Act Rule 18a-1(h); Exchange Act Rule 15c3-1(e)(1); SEC Release No. 34-86175 at 122.
37. Exchange Act Rule 15c3-1(c)(2)(v); Exchange Act Rule 18a-1; SEC Release No. 34-86175 at 124.
38. Exchange Act Rule 18a-1(g); Exchange Act Rule 15c3-1(d); SEC Release No. 34-86175 at 121-22.
39. Exchange Act Rule 18a-3(c)(1)(i).
40. Exchange Act Rule 18a-3(c)(1)(i)(A).
41. Exchange Act Rule 18a-3(c)(1)(i)(B).
42. *See* text accompanying footnote 55, below.
43. Exchange Act Rule 18a-3(d)(2)(ii).

44. This provides firms with additional time compared to the proposed version of the rule, which would have required the collection of margin at noon on the following business day. Exchange Act Rule 18a-3(c)(1)(ii).
45. Exchange Act Rule 18a-3(c)(4)(i)(C).
46. Exchange Act Rule 18a-3(c)(4)(v)(D).
47. Exchange Act Rule 18a-3(c)(3)(ii).
48. SEC Release No. 34-86175 at 174.
49. Exchange Act Rule 18a-3(c)(1)(iii)(A), (E).
50. Exchange Act Rule 18a-3(c)(1)(iii)(B).
51. SEC Release No. 34-86175 at 586.
52. SEC Release No. 34-86175 at 196.
53. Exchange Act Rule 18a-4(c)(1)(iii)(H)(2).
54. SEC Release No. 34-86175 at 495.
55. *See* Joint Statement on CFTC-SEC Portfolio Margining Harmonization Efforts (June 27, 2019).
56. The omnibus segregation requirements for stand-alone broker-dealers and broker-dealer SBSBs are covered in the amendments to Rules 15c3-3 and 15c3-3b. Meanwhile, the omnibus segregation requirements for stand-alone SBSBs, which includes firms that registered as OTC derivatives dealers, and bank SBSBs are laid out in Rules 18a-4 and 18a-4a. SEC Release No. 34-86175 at 212.
57. SEC Release No. 34-86175 at 212.
58. *See* Exchange Act § 3E(f); Exchange Act Rule 18a-4.
59. SEC Release No. 34-86175 at 212.
60. *Id.* at 213.
61. Excess securities collateral generally means “securities and money market instruments that are not being used to meet a variation margin requirement of the counterparty.” With respect to security-based swap transactions, “excess securities collateral means collateral delivered to the SBSB or stand-alone broker-dealer to meet an initial margin requirement of the counterparty as well as collateral held by the SBSB or stand-alone broker-dealer in excess of any applicable initial margin requirement (and that is not being used to meet a variation margin requirement).” SEC Release No. 34-86175 at 22.
62. *Id.* at 22, 230-31.
63. Exchange Act Rule 15c3-3(p)(1)(ii)(B); Exchange Act Rule 18a-4(a)(2)(ii); SEC Release No. 34-

86175 at 235.

64. SEC Release No. 34-86175 at 235.
65. Exchange Act Rule 15c3-3; Exchange Act Rule 18a-4.
66. The computation must be in accordance with the formula set forth in Rules 15c3-3b or 18a-4a.
67. The computation must be in accordance with the formula set forth in Rules 15c3-3b or 18a-4a.
68. Exchange Act Rule 18a-4(f); see also SEC Release No. 34-86175 at 227.
69. SEC Release No. 34-86175 at 220.
70. A broker-dealer that is dually registered as an MSBSP will be subject to the omnibus segregation requirements pursuant to Rule 15c3-3.
71. See 15 U.S.C. 78c-5(f); see also SEC Release No. 34-86175 at 213.
72. Exchange Act Rule 18a-19.
73. Entity-level requirements are primarily geared toward addressing concerns related to the “entity as a whole, with a particular focus on safety and soundness of the entity to reduce systemic risk in the U.S. financial system.” SEC Release No. 34-86175 at 271-72.
74. SEC Release No. 34-86175 at 280.
75. *Id.*
76. A foreign bank SBSD can include foreign banks, saving banks, cooperative banks, savings and loan associations, building and loan associations, or credit unions. SEC Release No. 34-86175 at 288.
77. Exchange Act Rule 18a-4(e)(1)(i); see also SEC Release No. 34-86175 at 288.
78. Exchange Act Rule 18a-4(e)(1)(ii).
79. Exchange Act Rule 18a-4(d).
80. Exchange Act § 3E(f)(1)(B).

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