



U.S. COMMODITY FUTURES TRADING COMMISSION

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Market Participants
Division

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RE: Staff Interpretation Regarding Tangible Net Worth Net Capital Computation and Financial Reporting for Swap Dealers and Major Swap Participants

The Market Participants Division (“Division”) of the Commodity Futures Trading Commission (“Commission”) is issuing this interpretation to clarify certain elements of Commission regulations 23.100 and 23.101,¹ which impose net capital obligations on swap dealers and major swap participants that are not subject to capital requirements of a “prudential regulator” (“non-bank SDs” and “non-bank MSPs,” respectively).² The Division is also issuing this interpretative guidance to clarify the application of certain financial reporting requirements contained in Commission regulation 23.105 that are applicable to non-bank SDs and non-bank MSPs. Specifically, this interpretation clarifies the Division’s views that:

- (1) Non-bank SDs utilizing the tangible net worth method of calculation of net capital set forth in regulation 23.101(a)(2) may satisfy the 15% revenue and 15% asset tests in the definition of “predominantly engaged in non-financial activities” under regulation 23.100 by applying the tests at either the non-bank SD entity level or at the level of the ultimate consolidated parent of the non-bank SD.
- (2) Non-bank SDs and non-bank MSPs permitted under regulation 23.105(b) to maintain books and records in accordance with International Financial Reporting Standards (“IFRS”), and permitted under regulation 23.105(d) and (e) to file financial reports in accordance with IFRS, may substitute IFRS for generally accepted accounting principles

¹ The Commission’s regulations may be found at 17 CFR Chapter I, and also are available through the Commission’s website, www.cftc.gov.

² The term “prudential regulator” is defined in regulation 1.3 (17 CFR § 1.3) to mean the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency, as applicable to the SD. SDs and MSPs subject to capital requirements of a prudential regulator are referred to in this interpretation as “bank SDs” and “bank MSPs,” respectively.

as adopted in the United States (“U.S. GAAP”) in the definition of both “tangible net worth” and “predominantly engaged in non-financial activities” set forth in regulation 23.100.

- (3) Non-bank SDs utilizing the tangible net worth method for calculation of net capital and non-bank MSPs may satisfy the additional positions and counterparty financial reporting requirements of regulation 23.105(l) on a quarterly basis instead of monthly basis.

Regulatory Background

The Commission on July 24, 2020, adopted capital requirements for non-bank SDs and non-bank MSPs, and also adopted financial reporting requirements for bank SDs, bank MSPs, non-bank SDs, and non-bank MSPs.³ The capital and financial reporting requirements were adopted pursuant to Sections 4s(e) and (f), respectively, of the Commodity Exchange Act (“Act”),⁴ and have a compliance date of October 6, 2021.

The final capital rules permit certain qualifying non-bank SDs to use a regulatory capital approach that is based on the firm’s tangible net worth.⁵ In order to qualify, a non-bank SD must be “predominantly engaged in non-financial activities.” The term “predominantly engaged in non-financial activities” is defined in regulation 23.100, and effectively provides that a non-bank SD, or its parent entity, does not receive more than 15% of its respective consolidated revenue from financial activities or hold financial assets in an amount that exceeds 15% of its respective total consolidated assets.⁶ A non-bank SD that chooses to use the tangible net worth method and meets the “predominantly engaged in non-financial activities” definition is required to compute its tangible net worth as the total amount of its assets (excluding goodwill and other intangible assets) less the total amount of its liabilities, with assets and liabilities computed in accordance with U.S. GAAP.⁷

The Commission’s final rules also impose regulatory capital requirements on non-bank MSPs. Regulation 23.101(b) requires each non-bank MSP to maintain positive tangible net worth at all times. Regulation 23.101(b) also incorporates the definition of the term “tangible net worth” set forth in regulation 23.100, which requires a non-bank MSP to compute its

³ The capital and financial reporting rules were published in the Federal Register on September 15, 2020. See Capital Requirements of Swap Dealers and Major Swap Participants, 85 FR 57462 (Sept. 15, 2020).

⁴ 7 U.S.C. § 1 *et seq.* The Act may also be accessed through the Commission’s website.

⁵ See 17 CFR § 23.101(a)(2). The tangible net worth capital approach requires a non-bank SD to maintain tangible net worth in an amount equal to or greater than the highest of (1) \$20 million, plus the non-bank SD’s market risk charges and credit risk charges associated with the firm’s swap dealing and related hedging activities, (2) 8% of the initial margin for each uncleared swap position of the non-bank SD, or (3) the amount of capital required by the National Futures Association.

⁶ See 17 CFR § 23.100 for the definition of “predominantly engaged in non-financial activities.”

⁷ See 17 CFR § 23.100 defining the term “tangible net worth.”

tangible net worth as its total assets (excluding goodwill and other intangible assets) less the total amount of its liabilities, all computed in accordance with U.S. GAAP.⁸

The final financial reporting requirements for non-bank SDs and non-bank MSPs are set forth in regulation 23.105. Regulation 23.105(d) requires each non-bank SD that uses the tangible net worth capital approach and each non-bank MSP to file unaudited financial reports with the Commission on a quarterly basis. In addition, regulation 23.105(l) requires each non-bank SD that uses the tangible net worth capital approach and each non-bank MSP to file certain position information and credit exposure information with the Commission on a monthly basis. The position information and credit exposure information are set forth in schedules contained in Appendix B to Subpart E of Part 23.

Staff Interpretation

The Division is issuing this interpretation in response to questions raised by market participants regarding the tangible net worth capital approach and certain financial reporting requirements.

a. *Non-Bank SDs Meeting the “Predominantly Engaged in Non-Financial Activities” Conditions*

The Division clarifies that a non-bank SD satisfies the definition of “predominantly engaged in non-financial activities” under regulation 23.100, and is permitted to use the tangible net worth capital approach, if either (1) the non-bank SD directly meets the 15% revenue test and the 15% assets test, or (2) if the non-bank SD’s ultimate consolidated parent entity meets the 15% revenue test and the 15% assets test.

As proposed by the Commission, a non-bank SD was required to meet the 15% revenue test and 15% assets test directly in order to qualify under the definition of “predominantly engaged in non-financial activities” to use the tangible net worth capital approach.⁹ In the final rulemaking adopting the non-bank SD capital rules, however, the Commission expanded the definition of “predominantly engaged in non-financial activities” to permit a SD to meet the 15% revenue test and 15% assets test directly or through its ultimate consolidated parent entity.¹⁰ The modification was a response, in part, to comments received that entities that are primarily engaged in non-financial (i.e., commercial) activities may establish non-bank SDs in order to “ring-fence” certain financial activities, including swap dealing activities, from the commercial operations of the entity.¹¹ The text of the final definition in regulation 23.100, however, did not

⁸ Id.

⁹ See Capital Requirements of Swap Dealers and Major Swap Participants, 81 FR 91252, 91263 (Dec. 16, 2016).

¹⁰ Id. See, also 17 CFR § 23.100 defining the term “predominantly engaged in non-financial activities.”

¹¹ See 85 FR 57464 at 57501-57502.

fully make clear that the 15% revenue test and 15% asset test could be applied at either the non-bank SD entity level or the level of the non-bank SD's consolidated parent. Specifically, the final rule text could be interpreted to provide that a non-bank SD that was part of a consolidated group could only qualify for the tangible net worth capital approach if the non-bank SD's ultimate consolidated parent entity satisfied the 15% revenue test and the 15% assets test.

The Division believes that the preamble to the final rules supports permitting non-bank SDs to satisfy the 15% revenue and 15% asset tests at either the non-bank SD level or at the non-bank SD's ultimate consolidated parent level. In this regard, the Commission stated in adopting the final regulations that the "modifications to the definition of the term 'predominantly engaged in non-financial activities' will permit a covered SD that either directly satisfies the 15% Assets Test and the 15% Revenue Test, or is a subsidiary of an ultimate parent entity that satisfies the 15% Assets Test and the 15% Revenue Test, to elect the Tangible Net Worth Capital Approach."¹² This statement, along with the Commission's stated objective of expanding the definition of "predominantly engaged in non-financial activities" to address commercial firms establishing separate legal entities to ring-fence swap dealing activities, indicate that the final rule was intended to provide flexibility for certain corporate structures to qualify to use the tangible net worth capital approach and was not intended to narrow the availability of the tangible net worth capital approach by requiring a non-bank SD's parent entity to meet the 15% revenue test and the 15% assets test.

b. Use of IFRS by Non-Bank SDs and Non-Bank MSPs to Calculate Tangible Net Worth

The Division clarifies that non-bank SDs and non-bank MSPs permitted to use IFRS for maintaining current books and records and for purposes of submitting financial reporting to the Commission under regulation 23.105 are also permitted to use IFRS in lieu of U.S. GAAP in computing "tangible net worth" under regulation 23.101.

Although not discussed in the final rules, non-bank SDs permitted to use the tangible net worth capital approach under regulation 23.101(a)(2) and non-bank MSPs required to maintain positive tangible net worth under regulation 23.101(b) are also permitted to utilize IFRS for maintaining current books and records and for complying with all financial reporting obligations under regulation 23.105, if they are not otherwise required to use U.S. GAAP.¹³ However, the

¹² Id.

¹³ Regulation 23.105(b) requires each non-bank SD and each non-bank MSP to maintain financial ledgers or other similar records which show or summarize, with appropriate references to supporting documents, each transaction affecting the non-bank SD's or non-bank MSP's asset, liability, income, expense, and capital accounts, and in which all of the non-bank SD's or non-bank MSP's asset, liability, and capital accounts are classified in accordance with U.S. GAAP. Regulation 23.105(b) further provides, however, that a non-bank SD or a non-bank MSP may prepare and keep records of the above transactions in accordance with IFRS in lieu of U.S. GAAP if the non-bank SD or non-bank MSP is not otherwise required to prepare financial statements in accordance with U.S. GAAP. In addition, regulation 23.105(d) and (e) requires each non-bank SD and each non-bank MSP to file financial reports prepared in accordance with U.S. GAAP with the Commission, unless the non-bank SD or non-

definition of “tangible net worth” in regulation 23.100 only references U.S. GAAP without contemplating the inconsistency that would be derived from maintaining current books and records and submitting financial reporting in accordance with IFRS, while requiring U.S. GAAP for the computation of tangible net worth. The Division clarifies that qualifying non-bank SDs and non-bank MSPs that maintain books and records in accordance with IFRS in lieu of U.S. GAAP, and file financial reports with the Commission prepared in accordance with IFRS in lieu of U.S. GAAP, may use IFRS to compute tangible net worth. An alternate approach would effectively require a non-bank SD or non-bank MSP to maintain two sets of accounting records nullifying the Commission’s authorization for such firms to maintain books and records in IFRS in lieu of U.S. GAAP.

c. Filing of Appendix B Financial Information by Non-Bank SDs and Non-Bank MSPs

The Division clarifies that non-bank SDs that use the tangible net worth capital approach and non-bank MSPs may file the financial information required under Appendix B to Subpart E of Part 23 on a quarterly, as opposed to monthly, basis with the Commission.

The Commission proposed to require each non-bank SD and each non-bank MSP to file unaudited financial reports and other financial information, including the position information and counterparty exposure information required by Appendix B to Subpart E of Part 23, with the Commission on a monthly basis.¹⁴ In response to comments, and based upon the Commission’s reconsideration of the issues, the Commission adopted final financial reporting regulations requiring monthly reporting of these items only with respect to non-bank SDs that utilize a capital approach other than the tangible net worth capital approach.¹⁵ With respect to non-bank SDs that qualify for, and elect, the tangible net worth capital approach and with respect to non-bank MSPs, the final regulations require such firms to file unaudited financial reports on a quarterly basis.¹⁶ The Commission, however, did not revise regulation 23.105(1) to reflect quarterly filing of Appendix B of Subpart E for non-bank SDs using the tangible net worth capital approach or for non-bank MSPs.

Division staff views the inconsistency in the quarterly financial report filing requirement and the monthly Appendix B filing requirement for non-bank SDs using the tangible net worth capital approach and non-bank MSPs as a technical oversight in the drafting of the final regulations. The Appendix B financial information supplements the unaudited financial reports and, as noted above, the Commission finalized the financial reporting rules to require only

bank MSP prepares its financial reports in accordance with IFRS and the non-bank SD or non-bank MSP is not otherwise required to prepare financial reports in accordance with U.S. GAAP.

¹⁴ See 81 FR 91252 at 91319.

¹⁵ See 17 CFR §§ 23.105(d) and (1).

¹⁶ Id.

RE: Tangible Net Worth Net Capital Computation for Swap Dealers

Page 6

quarterly reporting from non-bank SDs that use the tangible net worth capital approach and non-bank MSPs.

This interpretation represents the views of the Division only and does not necessarily represent the views of the Commission or those of any other Division or office of the Commission. The staff statements herein have no legal force or effect: they do not alter or amend applicable law, and they do not create any enforceable rights or new or additional obligations for any person. Questions regarding this interpretation may be directed to Jennifer Bauer, Special Counsel, 202-418-5472 or jbauer@cftc.gov; Josh Beale, Associate Director, 202-418-5446 or jbeale@cftc.gov; or Tom Smith, Deputy Director, 202-418-5495 or tsmith@cftc.gov.

Very truly yours,

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cc: National Futures Association