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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-92484; File No. S7-22-20]

Order Granting Conditional Substituted Compliance in Connection with Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the French Republic

July 23, 2021.

I. Overview

The French Autorité des Marchés Financiers ("AMF") and the Autorité de Contrôle Prudentiel et de Résolution ("ACPR"), the French financial authorities, have submitted a "substituted compliance" application requesting that the Securities and Exchange Commission ("Commission") determine, pursuant to the Securities Exchange Act of 1934 ("Exchange Act") rule 3a71-6, that security-based swap dealers and major security-based swap participants ("SBS Entities") subject to regulation in the French Republic ("France") conditionally may satisfy requirements under the Exchange Act by complying with comparable French and European Union ("EU") requirements.[1] The AMF and the ACPR ("French Authorities") sought substituted compliance in connection with certain Exchange Act requirements related to risk control, capital and margin, internal supervision and compliance, counterparty protection, and record keeping, reporting, notification, and securities counts.[2] The application incorporated

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[1] See Letter from Robert Ophèle, Chairman, AMF, and Denis Beau, Chairman, ACPR, to Vanessa Countryman, Secretary, Commission, dated Dec. 9, 2020 ("French Authorities' Application"). The application is available on the Commission's website at: https://www.sec.gov/files/full-french-application.pdf.

[2] "Risk control" includes requirements related to internal risk management, trade acknowledgment and verification, portfolio reconciliation and dispute resolution, portfolio compression and trading relationship documentation; "capital and margin" includes requirements related to capital applicable to non-prudentially regulated security-based swap dealers and to margin applicable to non-prudentially regulated SBS Entities; "internal supervision and compliance" includes requirements related to diligent supervision, conflicts of interest, information gathering under Exchange Act section 15F(j), 15 U.S.C. 78*o*-10(j), and chief compliance officers; "counterparty

comparability analyses between the relevant requirements in Exchange Act section 15F and the rules and regulations thereunder and applicable French and EU law, as well as information regarding French supervisory and enforcement frameworks.

On December 22, 2020, the Commission issued a notice of the French Authorities' Application, accompanied by a proposed order to grant substituted compliance with conditions in connection with the French Authorities' Application (the "proposed Order").[3] The proposed Order incorporated a number of conditions to tailor the scope of substituted compliance consistent with the prerequisite that relevant French and EU requirements produce regulatory outcomes that are comparable to relevant requirements under the Exchange Act. The Commission reopened the comment period for the proposed Order on April 5, 2021.[4]

As discussed below, the Commission is adopting a final Order that has been modified from the proposal in certain respects to address commenter concerns and to make clarifying changes.

II. Substituted Compliance Framework, Prerequisites and Commenter Issues of General Applicability

A. Substituted compliance framework and purpose

As the Commission has discussed previously,[5] Exchange Act rule 3a71-6 provides a framework whereby non-U.S. SBS Entities may satisfy certain requirements under Exchange Act

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protection" includes requirements related to disclosure of material risks and characteristics and material incentives or conflicts of interest, "know your counterparty," suitability of recommendations, fair and balanced communications, disclosure of daily marks and disclosure of clearing rights; and "record keeping, reporting, notification, and securities counts" includes requirements related to making and keeping current certain prescribed records, preservation of records, reporting, notification and securities counts.

[3] See Exchange Act Release No. 90766 (Dec. 22, 2020), 85 FR 85720, 85721 (Dec. 29, 2020) ("French Substituted Compliance Notice and Proposed Order").

[4] See Exchange Act Release No. 91477 (Apr. 5, 2021), 86 FR 18341 (Apr. 8, 2021) ("Reopening Release"). The reopened comment period ended on May 3, 2021.

[5] See French Substituted Compliance Notice and Proposed Order, 85 FR at 85721; Exchange Act Release No. 90765 (Dec. 22, 2020), 85 FR 85686, 85687 (Dec. 29, 2020) ("German Substituted Compliance Order").

section 15F by complying with comparable regulatory requirements of a foreign jurisdiction.[6] Because substituted compliance does not constitute exemptive relief, but instead provides an alternative method by which non-U.S. SBS Entities may comply with applicable Exchange Act requirements, the non-U.S. SBS Entities would remain subject to the relevant requirements under section 15F. The Commission accordingly will retain the authority to inspect, examine and supervise those SBS Entities' compliance and take enforcement action as appropriate. Under the substituted compliance framework, failure to comply with the applicable foreign requirements and other conditions to a substituted compliance order would lead to a violation of the applicable requirements under the Exchange Act and potential enforcement action by the Commission (as opposed to automatic revocation of the substituted compliance order).

Under rule 3a71-6, substituted compliance potentially is available in connection with certain section 15F requirements,[7] but is not available in connection with antifraud prohibitions and certain other requirements under the Federal securities laws.[8] SBS Entities in France accordingly must comply directly with those requirements notwithstanding the availability of substituted compliance for other requirements.

The substituted compliance framework reflects the cross-border nature of the security-based swap market, and is intended to promote efficiency and competition by helping to address potential duplication and inconsistency between relevant U.S. and foreign requirements.[9] In

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6 See Exchange Act Release No. 77617 (Apr. 14, 2016), 81 FR 29960, 30079 (May 13, 2016) ("Business Conduct Adopting Release").

7 17 CFR 240.3a71-6(d).

8 French Substituted Compliance Notice and Proposed Order, 85 FR at 85721 n.2 (addressing unavailability of substituted compliance in connection with antifraud provisions, as well as provisions related to transactions with counterparties that are not eligible contract participants ("ECPs"), segregation of customer assets, required clearing upon counterparty election, regulatory reporting and public dissemination, and registration of offerings).

9 See generally Business Conduct Adopting Release, 81 FR at 30073 (noting that the cross-border nature of the security-based swap market poses special regulatory challenges, in that relevant U.S. requirements "have the potential to lead to requirements that are duplicative of or in conflict with applicable foreign business conduct requirements, even when the two sets of requirements implement similar goals and lead to similar results").

practice, substituted compliance may be expected to help SBS Entities leverage their existing systems and practices to comply with relevant Exchange Act requirements in conjunction with their compliance with relevant foreign requirements. Market participants will begin to count security-based swap transactions toward the thresholds for registration with the Commission as an SBS Entity on August 6, 2021, and will be required to begin registering with the Commission on November 1, 2021.[10] Substituted compliance should assist relevant non-U.S. security-based swap market participants in preparing for registration.

B. Scope of substituted compliance

For entity-level Exchange Act requirements,[11] 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 French 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 substituted compliance for some of the business subject to the relevant French or EU requirements and comply directly with the Exchange Act for another part of the business that is subject to the relevant French 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 French requirements, the Covered Entity must either comply directly with the

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[10] See "Key Dates for Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants," available at https://www.sec.gov/page/key-dates-registration-security-based-swap-dealers-and-major-security-based-swap-participants.

[11] The entity-level requirements relate to 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 Exchange Act Release No. 86175 (June 21, 2019) 84 FR 43872, 43879 (Aug 22, 2019) ("Capital and Margin Adopting Release"); 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 Adopting Release No. 87782 (Dec. 18, 2019) 85 FR 6359, 6378 (Feb. 4, 2020) ("Risk Mitigation Adopting Release"); Business Conduct Adopting Release, 81 FR at 30064. 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.

Exchange Act for that business or comply with the terms of another applicable substituted compliance order.[12] For transaction-level Exchange Act requirements,[13] 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.

C. Specific prerequisites

1. Comparability of regulatory outcomes

Rule 3a71-6, adopted by the Commission in 2016, describes the requirements for the Commission to make a substituted compliance determination. Under the rule, the Commission must determine that the analogous foreign requirements are comparable to otherwise applicable requirements under the Exchange Act (i.e., the relevant requirements in the Exchange Act and the rules and regulations thereunder), after accounting for factors such as "the scope and objectives of the relevant foreign regulatory requirements" and "the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised" by the foreign authority.[14] The comparability assessments are to be based on a "holistic approach" that "will focus on the comparability of regulatory outcomes rather than predicating substituted compliance on requirement-by-requirement similarity."[15]

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12 In the context of the EMIR counterparties condition in paragraph (a)(5), a Covered Entity must choose: (1) to apply substituted compliance pursuant to the Order—including compliance with paragraph (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.

13 Transaction-level requirements are the counterparty protection requirements and the books and records requirements related to those counterparty protection requirements.

14 Exchange Act rule 3a71-6(a)(2)(i).

15 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85722; see also Business Conduct Adopting Release, 81 FR at 30078-79 (further recognizing that "different regulatory systems may be able to achieve some or all of those regulatory outcomes by using more or fewer specific requirements than the Commission, and that in assessing comparability the Commission may need to take into account the manner in which other regulatory systems are informed by business and market practices in those jurisdictions"). The Commission's assessment of a foreign authority's supervisory and enforcement effectiveness—as part of the

2. Memoranda of understanding

Exchange Act rule 3a71-6(a)(2)(ii) further predicates the availability of substituted compliance on the Commission and the foreign financial regulatory authority or authorities entering into a supervisory and enforcement memorandum of understanding and/or other arrangement with the relevant foreign financial regulatory authorities "addressing supervisory and enforcement cooperation and other matters arising under the substituted compliance determination."[16] Accordingly, the Commission and the AMF and the ACPR recently entered into a relevant memorandum of understanding.[17] Moreover, the Commission and the European Central Bank ("ECB") are in the process of developing a memorandum of understanding or other arrangement to address cooperation matters related to substituted compliance.[18] Those memoranda of understanding or other arrangements must be in place before Covered Entities may use substituted compliance to satisfy obligations under the Exchange Act.[19]

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broader comparability analysis—would be expected to consider not only overall oversight activities, but also oversight specifically directed at conduct and activity relevant to the substituted compliance determination. "For example, it would be difficult for the Commission to make a comparability determination in support of substituted compliance if oversight is directed solely at the local activities of foreign security-based swap dealers, as opposed to the cross-border activities of such dealers." Business Conduct Adopting Release, 81 FR at 30079 (footnote omitted). In the French Substituted Compliance Notice and Proposed Order, the Commission preliminarily concluded that this comparability prerequisite was met in connection with a number of requirements under the Exchange Act, in some cases with the addition of conditions to help ensure the comparability of regulatory outcomes.

16 Exchange Act rule 3a71-6(a)(2)(ii).

17 The Commission, the AMF and the ACPR have entered into a memorandum of understanding to address substituted compliance cooperation, a copy of which is on the Commission's website at www.sec.gov under the "Substituted Compliance" tab, which is located on the "Security-Based Swap Markets" page in the Division of Trading and Markets section of the site ("AMF and ACPR MOU"). The AMF, ACPR and the ECB share responsibility for supervising compliance with certain provisions of EU and French law.

18 The memorandum of understanding will set forth the conditions under which supervisory and enforcement information for certain subject matters, including but not limited to margin and capital, that is owned by the ECB, can be requested, shared, used and protected from unauthorized disclosure by the SEC and ECB. The memorandum of understanding will also serve as a framework for consultation, cooperation and the exchange of information between the SEC and the ECB in the supervision, enforcement and oversight of the covered firms.

19 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85721 n.4. The Commission expects to publish any such memoranda of understanding or arrangements on its website at www.sec.gov under the ''Substituted Compliance'' tab, which is located on the "Security-Based Swap Markets" page in the Division of Trading and Markets section of the site.

3. "Adequate assurances"

A foreign financial regulatory authority may submit a substituted compliance application only if the authority provides "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."[20] In the French Substituted Compliance Notice and Proposed Order, the Commission stated that the French Authorities had satisfied this prerequisite in the Commission's preliminary view, taking into account information and representations that the French Authorities provided regarding certain French and EU requirements that are relevant to the Commission's ability to inspect, and access the books and records of, firms using substituted compliance pursuant to the Order.[21] The Commission received no comments on this preliminary view and has not changed its view.

D. Commenter views of general applicability

As the Commission previously discussed, commenters raised a variety of concerns and other views regarding specific aspects of the proposed Order (apart from certain global concerns addressed below in part II.D.1 through 4.[22] Those included: concerns that the interplay between certain proposed MiFID-related conditions to substituted compliance for risk control requirements and a proposed EU cross-border condition would undermine the availability of substituted compliance;[23] views regarding the possibility of substituted compliance related to

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20 See Exchange Act rule 3a71-6(c)(3).

21 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85721 n.5.

22 See generally Reopening Release, 86 FR 18341. See also 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); and Letter from Etienne Barel, Deputy Chief Executive Officer, French Banking Federation (Jan. 25, 2021) ("FBF Letter I"). Comments may be found on the Commission's website at: https://www.sec.gov/comments/s7-22-20/s72220.htm.

23 Reopening Release, 86 FR at 18343 (expressing the view that the interplay of those MiFID conditions and the proposed EU cross-border condition "in practice would undermine the availability of substituted compliance for Covered Entities that have branches in EU Member

capital;[24] and views regarding substituted compliance in connection with books and records requirements.[25]

The Commission reopened the comment period in April 2021.[26] The Commission also requested comment on a number of specific issues, including: the potential removal of MiFID provisions from the trade acknowledgment and verification and trading relationship documentation conditions in conjunction with additional general conditions to address the resulting increased reliance upon EMIR;[27] the inclusion of additional capital standards;[28] the availability of greater flexibility in distinguishing between recordkeeping and reporting requirements;[29] limiting the definition of "covered entity";[30] and supplementing the internal supervision and compliance conditions.[31] In response, commenters expressed a range of views and identified a number of specific issues with the proposed conditions and prerequisites for each subject matter of the proposed Order for which substituted compliance is available.[32]

States for which the Commission has not entered into an applicable substituted compliance memorandum of understanding").

24 Id. at 18343-47.

25 Id. at 18347-48.

26 See Reopening Release, 86 FR 18341. The reopened comment period ended on May 3, 2021.

27 Id. at 18341-43.

28 Id. at 18343-47.

29 Id. at 18347-48.

30 Id. at 18348.

31 Id.

32 See 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") at 3-4. Comments may be found on the Commission's website at: https://www.sec.gov/comments/s7-22-20/s72220.htm.

1. Effects of non-compliance

One commenter addressed a Commission statement that non-compliance with applicable French and EU requirements would lead to a violation of relevant requirements under the Exchange Act. The commenter particularly requested that the Commission represent that SBS Entities "would not violate the Commission's requirements where the relevant foreign regulatory authority has found no violation of the comparable French or EU requirement and the SBS Entity's conduct would have complied with the Commission's requirements (even if the SBS Entity relied on French and EU rules that imposed stricter or additional requirements)."[33] The commenter also expressed a concern that the Commission might find a violation of the foreign laws even where the Commission's own requirements would be fulfilled.[34] The commenter further requested that the Commission state that it "will not independently examine for or otherwise assess whether an SBS Entity is complying with EU or French requirements."[35]

Although the Commission expects to take the views of foreign regulatory authorities into account when it considers whether registered entities have complied with the conditions to substituted compliance, the Commission cannot make the requested representations. It is for the Commission – not foreign regulators – to determine whether a non-U.S. SBS Entity has complied with the conditions to substituted compliance and with the Federal securities laws. Moreover, as noted, even with substituted compliance the Commission retains its full authority to inspect, examine and supervise registered entities' compliance with the Federal securities laws, and to take enforcement action as appropriate.[36]

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[33] SIFMA Letter I at 9; see also FBF Letter I at 2.

[34] See SIFMA Letter I at 9 n.22.

[35] SIFMA Letter I at 9.

[36] See Business Conduct Adopting Release, 81 FR at 30079.

2. Prerequisites to substituted compliance

One commenter stated that the Commission should make a positive substituted compliance determination only when the Commission determines that granting substituted compliance promotes the protection of the U.S. financial system.[37] The commenter also stated that grants of substituted compliance must be predicated on a "well-supported, evidence-based determination" that the relevant foreign requirements will produce "substantially similar" regulatory outcomes.[38] Congress gave the Commission authority in Title VII to implement a security-based swap framework to address the potential effects of security-based swap activity on U.S. market participants, the financial stability of the United States, the transparency of the U.S. financial system and the protection of counterparties.[39] When adopting rules regarding the application of Title VII's definitions of "security-based swap dealer" and "major security-based swap participant" in the cross-border context, the Commission was guided by the purposes of Title VII and the applicable requirements of the Exchange Act, which include consideration of not only risk to the U.S. financial system but also other factors such as counterparty protection, transparency, prevention of evasion, economic impacts and consultation and coordination with other U.S. financial regulatory authorities and foreign financial regulatory authorities.[40] In its

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37 See Better Markets Letter at 3-4.

38 See id. at 4.

39 See Exchange Act Release No. 72472 (June 25, 2014), 79 FR 47278, 47286 (Aug. 12, 2014) ("Cross-Border Entity Definitions Adopting Release") (citing Pub. L. 111-203, Preamble (stating that the Dodd-Frank Act was enacted "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes"); Pub. L. 111-203, sections 701-774 (providing for, among other things, a comprehensive new regulatory framework for security-based swaps, including by: (i) providing for the registration and comprehensive regulation of security-based swap dealers and major security-based swap participants; (ii) imposing clearing and trade execution requirements on security-based swaps, subject to certain exceptions; and (iii) creating real-time reporting and public dissemination regimes for security-based swaps)).

40 See Cross-Border Entity Definitions Adopting Release, 79 FR at 47292 (purposes of Title VII include consideration of risk to the U.S. financial system and promotion of transparency in the U.S. financial system); Exchange Act section 30(c), 15 U.S.C. 78dd(c) (Commission rulemaking authority to prevent evasion of Title VII); Exchange Act section 3(f), 15 U.S.C. 78c(f) (requirement to consider whether certain Commission rulemaking actions would promote

registration rules for these SBS Entities, the Commission determined that a foreign market participant whose U.S.-nexus security-based swap activity qualifies it as an SBS Entity would be required to register as such, without substituted compliance available for registration requirements.[41] The Commission concluded that obliging these foreign persons to register serves an important regulatory function that would be significantly impaired by permitting substituted compliance for registration requirements.[42] This registration requirement thus puts into practice the Commission's consideration of the purposes of Title VII and the applicable requirements of the Exchange Act in its adoption of the definitions of "security-based swap dealer" and "major security-based swap participant" in the cross-border context, and ensures that such firms will be subject to the jurisdiction of the Commission. Moreover, the rules applicable to these registered foreign SBS Entities reflect the Commission's best judgment for how to achieve the purposes of

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efficiency, competition and capital formation); Exchange Act section 23(a)(2), 15 U.S.C. 78w(a)(2) (requirement to consider the impact of Exchange Act rules and regulations on competition and prohibition on adopting rules or regulations that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act); Dodd-Frank Act section 712(a)(2), 15 U.S.C. 8302 (requirement to consult and coordinate with U.S. financial regulatory authorities on Title VII rulemaking); Dodd-Frank Act section 752(a), 15 U.S.C. 8325 (requirement to consult and coordinate, as appropriate, with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of security-based swaps and security-based swap entities); see also Exchange Act Release No. 77104 (Feb. 10, 2016), 81 FR 8598, 8599 (Feb. 19, 2016) ("ANE Adopting Release") ("A key part of [the Title VII] framework is the regulation of security-based swap dealers, which may transact extensively with counterparties established or located in other jurisdictions and, in doing so, may conduct sales and trading activity in one jurisdiction and book the resulting transactions in another. These market realities and the potential impact that these activities may have on U.S. persons and potentially the U.S. financial system have informed our consideration of these rules."); Exchange Act Release No. 87780 (Dec. 18, 2019), 85 FR 6270, 6272 and n.26 (Feb. 4, 2020) ("Cross-Border Adopting Release") ("[T]he Title VII SBS Entity requirements…serve a number of regulatory purposes apart from mitigating counterparty and operational risks, 'including enhancing counterparty protections and market integrity, increasing transparency, and mitigating risk to participants in the financial markets and the U.S. financial system more broadly.'" "The Commission's actions to mitigate the negative consequences potentially associated with the various uses of [the 'arranged, negotiated or executed' test] accordingly are designed to do so while preserving the important Title VII interests that the Commission advanced when it incorporated the test into the various cross-border rules.") (internal citations omitted).

41 See Exchange Act Release No. 75611 (Aug. 5, 2015), 80 FR 48964, 48972-73 (Aug. 14, 2015) ("Registration Adopting Release").

42 See id.

Title VII and satisfy the requirements of the Exchange Act, including the Commission's consideration of risk to the U.S. financial system.[43]

The Commission's rules for registered foreign SBS Entities thus reflect the Commission's consistent consideration of all of the purposes of Title VII and relevant parts of the Exchange Act, first in the context of its adoption of the definitions of "security-based swap dealer" and "major security-based swap participant," then in its decision to require foreign SBS Entities to register and finally in its adoption of cross-border rules for SBS Entities pursuant to Title VII. When making a substituted compliance determination, the Commission's task, as outlined in rule 3a71-6, is to evaluate whether the relevant foreign requirements are comparable to these Title VII-based requirements and relevant provisions of the Exchange Act. The comparability assessments are to be based on a "holistic, outcomes-oriented framework,"[44] which in the Commission's view – consistent with the commenter's view – includes "inquiry regarding whether foreign requirements adequately reflect the interests and protections associated with the particular Title VII requirement."[45] Also consistent with the commenter's view, the Commission's comparability assessments reflect a close reading of the relevant French and EU requirements. In addition, the Commission recognizes that other regulatory regimes will have exclusions, exceptions and exemptions that may not align perfectly with the corresponding requirements under the Exchange Act.[46] Accordingly, where French and EU requirements produce comparable outcomes – with or without conditions as discussed in part III.B below – notwithstanding those particular differences, and taking into account the scope and objectives

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43 See Cross-Border Entity Definitions Adopting Release, 79 FR at 47286 n.65 ("Future rulemakings that depend on [the definitions of 'security-based swap dealer' and 'major security-based swap participant'] are intended to address the transparency, risk, and customer protection goals of Title VII.").

44 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85722; see also Business Conduct Adopting Release, 81 FR at 30076, 30078-79.

45 See Business Conduct Adopting Release, 81 FR at 30067.

46 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85722 n.17; see also Business Conduct Adopting Release, 81 FR at 30076, 30078-79.

and the effectiveness of supervision and enforcement of those requirements, the Commission has determined that the relevant French and EU requirements are comparable and has made a positive substituted compliance determination. Conversely, where those exclusions, exemptions and exceptions lead to outcomes that are not comparable – taking into account potential conditions – the Commission has not made a positive substituted compliance determination.

The Commission also is including certain conditions in the Order. The commenter stated that the inclusion of conditions should be viewed as an indication that the requirements of substituted compliance have not been met and as creating "ad hoc, custom-made rules to supplement inadequate rules of other jurisdictions."[47] Pursuant to rule 3a71-6, the Commission may make a conditional or unconditional substituted compliance determination.[48] As described in greater detail in part III.B below, many of the conditions in the Order are designed to make substituted compliance available to Covered Entities only when the relevant French and EU requirements in fact apply to the relevant security-based swap activity in a way that promotes comparable regulatory outcomes. The commenter correctly notes that the Order also employs conditions to promote comparability.[49] For example, substituted compliance in connection with Exchange Act rule 15Fi-3(c) dispute reporting provisions is conditioned in part on the Covered Entity providing the Commission with the dispute reports required under French law.[50] Consistent with rule 3a71-6, conditioning substituted compliance on the Commission receiving those reports helps to promote timely notice of disputes to support a comparable regulatory outcome.

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47 See Better Markets Letter at 4.

48 See Exchange Act rule 3a71-6(a)(1).

49 See Better Markets Letter at 2.

50 See para. (b)(3)(ii) of the Order.

3. Ensuring ongoing appropriateness of substituted compliance

One commenter stated that the Commission "must ensure, on an ongoing basis, that each grant of substituted compliance remains appropriate over time."[51] The commenter added that substituted compliance orders and memoranda of understanding should incorporate the obligation that the Commission be apprised regarding the effectiveness of the jurisdiction's supervision and enforcement programs, and to immediately apprise the Commission of material changes to the regulatory regime.[52] The Commission concurs that the ongoing availability of substituted compliance should account for relevant changes in the foreign jurisdiction's regulatory requirements and in the effectiveness of that jurisdiction's supervisory and enforcement program.[53] Accordingly, the Commission and the French Authorities recently entered into a substituted compliance memorandum of understanding that addresses ongoing information regarding potential changes to substantive legal requirements and supervisory and enforcement effectiveness.[54] Additionally, the Commission and the ECB are in the process of developing a memorandum of understanding to address cooperation matters related to substituted compliance. The Commission believes that these arrangements will provide timely information to ensure that the Commission is aware of material developments that may affect the comparability of the relevant French and EU requirements, including the scope and objectives of those requirements and the effectiveness of the French Authorities' supervision and enforcement

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51 Better Markets Letter at 5.

52 Id.

53 See Business Conduct Adopting Release, 81 FR at 30078-79 (stating that order conditions and memoranda of understanding are possible tools for providing that the Commission be notified of material changes).

54 The memorandum of understanding between the Commission and the French Authorities in part provides that the French Authorities will provide "ongoing information sharing" regarding Firm Information (incorporating supervisory and related information as to the Covered Entities using substituted compliance) and regarding Regulatory Change Information (incorporating information about any material publicly available draft, proposed, or final change in law, regulation, or order of the jurisdiction of the French Authorities that may have a material impact on the firms at issue with respect to their relevant activities). See note 17, supra (information on publication of memoranda of understanding with the French Authorities and ECB).

programs. In response to any such developments, the Commission may amend the Order as needed to ensure that it continues to require a Covered Entity to comply with comparable French and EU requirements, or may withdraw the Order if the relevant French or EU requirements are no longer comparable.[55] Moreover, substituted compliance under the Order is conditioned on the Commission having these memoranda of understanding, or another arrangement with the French Authorities and ECB addressing cooperation with respect to the Order, at the time the Covered Entity makes use of substituted compliance.[56] If the arrangements in the memoranda of understanding prove in practice not to provide information about relevant developments, the Commission could terminate the memoranda of understanding in accordance with its terms and/or amend or withdraw the Order.[57] If the Commission, the French Authorities or the ECB terminates either memorandum of understanding, Covered Entities would not be able to rely on substituted compliance under the Order to satisfy Exchange Act compliance obligations that arise after the termination takes effect. For these reasons, in the Commission's view, the Order's memoranda of understanding conditions, coupled with the ongoing information sharing provisions in the memoranda of understanding with the French Authorities and with the ECB, establish the commenter's suggested mechanism to apprise the Commission of changes that may affect the ongoing appropriateness of substituted compliance.

4. Request for Transition Period

Commenters stated that the Commission's proposed approach to certain entity-level requirements could result in the Commission's requirements still applying to a non-U.S. Entity's security-based swap transaction with non-U.S. counterparties and a resulting need for SBS Entities to obtain written agreement from their non-U.S. counterparties.[58] As a result,

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55 Any such amendment or withdrawal may be at the Commission's own initiative after appropriate notice and opportunity for comment. See Exchange Act rule 3a71-6(a)(3).

56 See part II.C.2, supra; paras. (a)(7) and (a)(8) of the Order.

57 See note 18, supra.

58 See SIFMA Letter I at 10; FBF Letter I at 3.

commenters requested a one-year transition period from the November 1, 2021, date by which security-based swap dealers must register with the Commission to come into compliance with any documentation requirements.[59]

The Commission is not providing an additional transition period at this time for documentation requirements related to Exchange Act requirements that will apply to Covered Entities' existing non-U.S. counterparties. The registration compliance date for U.S. and non-U.S. SBS Entities is October 6, 2021, and that is also the compliance date for the entity-level requirements at issue. These dates have been known to potential SBS Entities since February 4, 2020.[60] In areas where the Commission makes a positive substituted compliance determination under the Order, Covered Entities will have additional flexibility with respect to how to comply with the relevant Exchange Act requirements, but they, like all registered SBS Entities, must comply with the Exchange Act as of the registration compliance date. The Commission staff will be available to discuss implementation issues with Covered Entities during the implementation period.

III. General Availability of Substituted Compliance under the Order

A. Covered Entities

1. Proposed approach

Under the proposed Order, the definition of "Covered Entity" specified which entities could make use of substituted compliance. Consistent with the availability of substituted compliance under Exchange Act rule 3a71-6, the proposed definition in part would limit the availability of substituted compliance to registered SBS Entities that are not U.S. persons. In addition, to help ensure that firms that rely on substituted compliance are subject to relevant French and EU requirements and oversight, the proposed definition would require that Covered Entities be investment firms authorized to provide investment services by the AMF or credit

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59 Id.

60 See Exchange Act Release No. 87780 (Dec. 18, 2019), 85 FR 6270 at 6345-46 (Feb. 4, 2020).

institutions authorized by the ACPR after approval by the AMF of its program of operations to provide investment services or perform investment activities in France.[61]

2. Commenter views and final provisions

One commenter requested changes to the proposed "Covered Entity" definition, to reflect that under the French framework the requisite authorizations to provide credit and investment services are provided by the ACPR, in conjunction with the AMF's approval of the provision of investment services.[62] In addition, as described in the French Substituted Compliance Notice and Proposed Order, and confirmed by the AMF,[63] the AMF uses a risk-based approach to supervision whereby investment firms are categorized within four Tiers. Tier 1 firms receive the most supervisory attention and the staff has been told that all firms that use substituted compliance will be treated as Tier 1 firms.[64] The Commission has revised the Order in response to the comment and to reflect the AMF's approach.[65]

B. Additional general conditions

1. Proposed approach

The proposed Order incorporated a number of additional general conditions and other prerequisites, to help ensure that the relevant French and EU requirements that form the basis for substituted compliance in practice will apply to the Covered Entity's security-based swap business and activities, and to promote the Commission's oversight over entities that avail themselves of substituted compliance:

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61 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85723.

62 See SIFMA Letter II at Appendix A.

63 See Memorandum, dated June 10, 2021, from Patrice Aguesse of the French AMF.

64 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85735.

65 See para. (g)(1)(iii) of the Order (providing that a Covered Entity in part means "an investment firm authorized by the ACPR to provide investment services or perform investment activities in the French Republic, or a credit institution authorized by the ACPR, after approval by the AMF of its program of operations to provide investment services or perform investment activities in the French Republic, and supervised by the AMF under its Tier 1 framework").

- "Subject to and Complies with" applicability condition – For each relevant section of the proposed Order, a positive substituted compliance determination would be predicated on the entity being subject to and complying with the applicable French and EU requirements needed to establish comparability.[66]
- MiFID "investment services or activities" – The Covered Entity's security-based swap activities would have to constitute "investment services or activities" for purposes of applicable provisions[67] under MiFID, MFC and related EU and French requirements, and must fall within the scope of the firm's authorization from the AMF or from the ACPR after approval by the AMF of the firm's program of operations.[68]
- Counterparties as MiFID "clients" – The Covered Entity's counterparties (or potential counterparties) would have to be "clients" (or potential "clients") for purposes of MiFID,

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66 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85723. The Commission stated, as an example, that this proposed condition would not be satisfied when the comparable French or EU requirements would not apply to the security-based swap activities of a third-country branch of a French SBS Entity.

67 Under this condition, a Covered Entity's security-based swap activities must constitute "investment services or activities" only to the extent that the relevant part of the Order requires the Covered Entity to be subject to and comply with a provision of MiFID, provisions under MFC that implement MiFID and related EU and French requirements. If the relevant part of the Order does not require the Covered Entity to be subject to and comply with one of those provisions, then the Covered Entity's security-based swap activities do not have to constitute "investment services or activities" to be able to use substituted compliance under that part of the Order.

68 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85723. The EU's Markets in Financial Instruments Directive ("MiFID"), Directive 2014/65/EU, has been implemented in France as part of article L. 511 to the French Monetary and Financial Code — Code monétaire et financier ("MFC"). MiFID and MFC address, inter alia, organizational, compliance and conduct requirements applicable to nonbank "investment firms." In significant part, those requirements also apply to credit institutions that provide investment services or perform investment activities. Commission Delegated Regulation (EU) 2017/565 ("MiFID Org Reg") in part supplements MiFID with respect to organizational requirements for firms. The Markets in Financial Instruments Regulation ("MiFIR"), Regulation (EU) 648/2012, generally addresses trading venues and transparency. Commission Delegated Directive (EU) 2017/593 ("MiFID Delegated Directive") in part supplements MiFID with regard to safeguarding client property, and in France is implemented in relevant part by the Règlement Général de L'Autorité des Marchés Financiers ("AMF General Regulation"). Directive (EU) 2015/849 ("MLD") addresses requirements on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and in France is implemented by article L. 561 to the MFC.

provisions under MFC that implement MiFID and/or other EU and French requirements adopted pursuant to those provisions.[69]

- MiFID "financial instruments" – The relevant security-based swaps would have to be "financial instruments" for purposes of applicable provisions under MiFID, MFC and related EU and French requirements.[70]
- CRD "institutions" – The Covered Entity would have to be an "institution" for purposes of applicable provisions under CRD, MFC, CRR and related EU and French requirements.[71]
- Memoranda of understanding – Consistent with the requirements of rule 3a71-6 and the Commission's need for access to information regarding registered entities, substituted compliance under the proposed Order would be conditioned on the Commission having applicable memoranda of understanding or other arrangements in place with the French Authorities and with the ECB, addressing cooperation with respect to the Order at the time the Covered Entity makes use of substituted compliance.[72]

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69 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85723.

70 Id.

71 Id. The EU's Capital Requirements Directive IV ("CRD"), Directive 2013/36/EU has been adopted in France as part of article L. 533 to the MFC, and sets forth prudential requirements and certain related requirements applicable to credit institutions and certain nonbank investment firms. Certain CRD requirements regarding reporting obligations have been incorporated into French law as part of articles L. 511 and L. 634 to the MFC. The Capital Requirements Regulation ("CRR"), Regulation (EU) 575/2013, further addresses prudential requirements and related recordkeeping requirements for credit institutions and certain investment firms. Commission Implementing Regulation (EU) 680/2014 ("CRR Reporting ITS") sets forth implementing technical standards regarding supervisory reporting. Pursuant to amendments that will become effective in June 2021, the requirements of CRD and the CRR will apply to credit institutions and to certain nonbank undertakings (that carry on activities involving dealing, portfolio management, investment advice and underwriting/placing) that meet specified thresholds (e.g., consolidated assets of €30 billion or more). See generally Investment Firms Regulation ("IFR"), Regulation (EU) 2019/2033, art. 62 (amending certain definitions in the CRR).

72 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85723. The Commission, AMF and ACPR have entered into a memorandum of understanding to address substituted compliance cooperation. The Commission and the ECB are also in the process of developing a memorandum of understanding or other arrangement to address cooperation matters related to substituted compliance. See notes 17-19, supra. Consistent with the Order, Covered

- Notice of reliance on substituted compliance – To assist the Commission's oversight of firms that avail themselves of substituted compliance, a Covered Entity relying on the substituted compliance order would have to provide notice of its intent to rely on the Order by notifying the Commission in writing.[73]

When the Commission reopened the comment period and addressed the possible removal of certain MiFID-related conditions, the Commission also discussed the possibility of adding two new EMIR-related conditions related to "counterparty" status under EMIR and related to products subject to the European Market Infrastructure Regulation ("EMIR"), to satisfy the prerequisites to substituted compliance.[74] The Commission explained that those additional two conditions may "promote certainty that EMIR will apply and help preclude gaps between the regulatory outcomes associated with the Exchange Act and those associated with the relevant EMIR provisions."[75] This is particularly significant due to the Order's removal of proposed MiFID-related conditions with respect to substituted compliance for trade acknowledgement and verification requirements and for trading relationship documentation requirements, and the accompanying heightened reliance on certain EMIR-related conditions.[76] The two additional EMIR-related conditions are:

- Covered Entity's counterparties as EMIR "counterparties" – For each condition in the proposed Order that requires the application of, and compliance with, provisions of EMIR, Commission Delegated Regulation (EU) 149/2013 ("EMIR RTS") and/or Delegated Regulation (EU) 2016/2251 ("EMIR Margin RTS"), if the counterparty to the Covered Entity is not a "financial counterparty" or "non-financial counterparty" as

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Entities must ensure that this memorandum of understanding remains in place at the time the Covered Entity relies on substituted compliance.

73 French Substituted Compliance Notice and Proposed Order, 85 FR at 85723.

74 Reopening Release, 86 FR at 18342.

75 Id.

76 See generally parts IV.B.2 and IV.B.5 infra.

defined in EMIR articles 2(8) or 2(9), respectively, the Covered Entity must comply with the applicable condition as if the counterparty were a financial counterparty or non-financial counterparty. In other words, the Covered Entity would be subject to the relevant requirements under EMIR even if the counterparty is not authorized pursuant to EU law as anticipated by the EMIR article 2(8) "financial counterparty" definition, or 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), as anticipated by the EMIR article 2(9) ''non-financial counterparty'' definition.[77]

- Security-based swap status under EMIR - For each condition in the proposed Order that requires the application of, and compliance with, provisions of EMIR, EMIR RTS and/or EMIR Margin RTS, either: (1) the relevant security-based swap must be an "OTC derivative" or "OTC derivative contract," as defined in EMIR article 2(7), that has not been cleared by a central counterparty ("CCP") and otherwise is subject to the provisions of EMIR; or (2) the relevant security-based swap must have been cleared by a central counterparty that has been authorized or recognized to clear derivatives contracts in the EU.[78]

2. Commenter views and final provisions

Commenters addressed the proposed general conditions related to MiFID "clients," the memoranda of understanding, and the notice to the Commission.[79] Commenters also addressed the two additional EMIR-related conditions the Commission discussed when it reopened the comment period.[80] For the reasons discussed below, the Order largely incorporates the general

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77 See Reopening Release, 86 FR at 18342 n.9.

78 Id. at 18342.

79 See SIFMA Letter II at 7, 16, and Appendix A; FBF Letter II at 3 (addressing counterparties as MiFID "clients"); Better Markets Letter at 5 (addressing the memorandum of understanding).

80 See SIFMA Letter II at 4; FBF Letter II at 2; Better Markets Letter at 5-7.

conditions as proposed, subject to certain changes and the addition of the two EMIR-related conditions.[81] In the Commission's view, the conditions are structured appropriately to predicate a positive substituted compliance determination on the applicability of relevant French and EU requirements needed to establish comparability, as well as on the continued effectiveness of the requisite MOU, and the provision of notice to the Commission regarding the Covered Entity's intent to rely on substituted compliance.

a. Counterparties as MiFID "clients"

One commenter requested that the Commission modify the general condition regarding MiFID client status, which as proposed required that the counterparty be a "client" (or potential "client") as defined in MiFID, such that the condition also would encompass counterparties that are "acting through an agent which the Covered Entity treats as its 'client' (or potential 'client')."[82] The commenter stated that this change would address circumstances in which an agent acted on its counterparty's behalf, "such as an investment manager acting for a fund," reasoning that in practice entities "will look to the agent" rather than the agent's principal when satisfying applicable requirements.[83]

As noted above, the proposed Order would require a Covered Entity to be "subject to and comply with" relevant MiFID-based requirements. The Commission proposed that requirement of the proposed Order to ensure that comparable MiFID-based requirements in practice would apply to a Covered Entity using substituted compliance. The condition in paragraph (a)(2) to the proposed Order would ensure that the Covered Entity's counterparty—i.e., the entity to whom it

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81 The Commission is adopting, largely as proposed, other general conditions that were not the subject of comments and that are not otherwise addressed below. See paras. (a)(1), (a)(3), and (a)(4) of the Order. The Commission is making technical changes to clarify the captions of certain of the general conditions (e.g., in the final Order the caption to the proposed condition related to "Activities as 'investment services or activities'" now refers to "Activities as MiFID 'investment services or activities'"). Certain of the general conditions also have been renumbered from the proposal.

82 SIFMA Letter II at Appendix A.

83 SIFMA Letter II at 7.

owes its various duties under the Exchange Act—is the "client" to whom the Covered Entity owes its performance of the duties to which it is subject under the comparable MiFID-based requirements.[84] The Commission believes that, in the case of an agent acting on behalf of a principal, if the principal is the counterparty for purposes of the relevant Exchange Act requirement, then this condition should require the principal, as the counterparty, to be the "client" for purposes of the relevant MiFID-based requirements. If the Covered Entity instead treats the agent as the "client," then the Covered Entity would not be "subject to" French and EU requirements that are comparable to Exchange Act requirements related to counterparties. Accordingly, the Commission is not amending the Order to modify the condition in paragraph (a)(2) to permit a Covered Entity to treat an agent, rather than the agent's principal, as its client with regard to the relevant MiFID-based requirements. In taking this position, the Commission does not prohibit Covered Entities from working with agents or others acting on behalf of a counterparty. Rather, the Covered Entity must ensure that, in working with the agent, it fulfills any duties owed to a "client" (or potential "client") in relation to the counterparty.[85]

b. Memoranda of understanding

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[84] Some provisions of the MiFID-based requirements cited in the condition, such as certain organizational requirements, do not pertain to counterparties or clients. In those cases, there is no "relevant counterparty (or potential counterparty)" for purposes of the condition, and the condition would have no effect.

[85] MiFID article 26 permits firms to rely upon information about a client received from another French and EU-regulated firm. Under that provision, the other firm is legally responsible for the completeness and accuracy of any information about the client that the other firm receives from the first firm. The Commission believes that it is appropriate to permit a Covered Entity to rely on information about its client communicated by another French and EU-regulated firm on behalf of the client. Accordingly, the application of this provision would not cause the Covered Entity to be not "subject to" the relevant French and EU requirements listed in the Order, and thus would not impact the Covered Entity's ability to use substituted compliance in relation to those communications. On the other hand, MiFID article 26 also provides that the other firm is legally responsible for the suitability of advice and recommendations provided to the client. The other firm, however, may not be a Covered Entity applying substituted compliance pursuant to the Order. Accordingly, the Commission believes that a Covered Entity relying on the suitability assessment of another firm pursuant to MiFID article 26 is not "subject to" the relevant French suitability requirements listed in the Order, and thus may not apply substituted compliance for those recommendations.

Commenters stated that a separate memorandum of understanding with the ECB need not be in place before SBS Entities can rely on the Order, based on the rationale that a memorandum of understanding containing certain assurances from the AMF and ACPR would be sufficient to ensure the Commission can promptly obtain relevant ECB-controlled information.[86] The Commission disagrees that such assurances would be sufficient. As the Order in part addresses substituted compliance for matters within the purview of the ECB, including but not limited to capital and margin requirements, the Commission believes that a memorandum of understanding with the ECB must be in place at the time an SBS Entity relies on the Order. As a result, the Order incorporates, as proposed, separate conditions related to the French Authorities and to the ECB memoranda of understanding.[87]

c. Notice of reliance on substituted compliance

One commenter[88] requested that the Commission modify the proposed notice condition to correspond with the analogous condition that the Commission proposed in connection with the proposed substituted compliance order for the United Kingdom (UK).[89] The Commission agrees that the notice requirements for the substituted compliance orders should be consistent. As a result, the condition has been modified from the French proposed Order to add flexibility by stating that the notice must be sent to the Commission in the manner specified on the Commission's website (while the proposed Order instead referred to an email address).[90] Moreover, the condition further has been modified from the proposal by stating that the notice must identify each specific substituted compliance determination for which the Covered Entity

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86 See SIFMA Letter I at 16; see also FBF Letter I at 3.

87 See paras. (a)(7) and (a)(8) of the Order

88 SIFMA Letter II at Appendix A.

89 Exchange Act Release No. 91476 (Apr. 5, 2021), 86 FR 18378 (Apr. 8, 2021) ("UK Proposed Order").

90 See para. (a)(9) of the proposed Order.

intends to apply substituted compliance.[91] Further, a Covered Entity must promptly update the notice if it intends to modify its reliance on the positive substituted compliance determinations in the Order.[92] Every SBS 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,[93] and specificity as to the scope of the entity's reliance on substituted compliance is necessary to facilitate the Commission's oversight under the Order.

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91 See para. (a)(9) of the Order. If the Covered Entity intends to rely on all the substituted compliance determinations in a given paragraph of the Order, it can 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 Order, it can 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 will need to indicate in the notice that it is relying on paragraph (c)(2) of the Order (the margin determination). In this case, paragraph (c)(1) of the Order (the capital determination) will be excluded from the notice and the Covered Entity will need to comply with the Exchange Act capital requirements. Further, as discussed below, the recordkeeping and reporting determinations in the 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 Order sets forth the Commission's substituted compliance determinations with respect to the requirements of Exchange Act rule 18a-5, 17 CFR 240.18a-5. These determinations are set forth in paragraphs (f)(1)(i)(A) through (O) of the Order. If a Covered Entity intends to rely on some but not all of the determinations, it will need to identify in the notice the specific 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 will need to comply with the Exchange Act rule 18a-5 requirement. Finally, a Covered Entity is 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 will need to indicate the class of transactions (e.g., transactions with French 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 is 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 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 Order. In this case, the notice will need to indicate the scope of security-based swap business (e.g., security-based swap business carried on from an establishment in France) for which the Covered Entity is applying substituted compliance with respect to the relevant Exchange Act entity-level requirements.

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

93 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85734.

d. Additional EMIR-related conditions

The final rules have been modified from the proposal to add two general conditions that address Covered Entities' reliance on the EMIR-related provisions. The additions should help ensure that the relevant EMIR-related provisions will apply in fact, and help avoid any gaps between the regulatory outcomes associated with Exchange Act requirements and regulatory outcomes associated with those EMIR-related provisions. Consistent with the discussion regarding scope of substituted compliance in part II.B, in the context of the EMIR counterparties condition in paragraph (a)(5), a Covered Entity must choose (1) to apply substituted compliance pursuant to the Order—including compliance with paragraph (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.

Some commenters expressed general support for adding the two additional EMIR-related general conditions to the Order.[94] One commenter disagreed with including any additional EMIR-related conditions, expressing the view that if "some industry participants may not be able to take advantage of substituted compliance under the SEC's proposed framework is not, in and of itself, a reason to change the framework."[95]

The first new general condition addresses the fact that the "financial counterparty" and "non-financial counterparty" definitions that trigger the application of the relevant EMIR provisions are predicated on the entity being an undertaking established in the EU.[96] The conditions are not based upon the concern that some industry participants may not be able to take advantage of substituted compliance, but rather the conditions are intended to help ensure that

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94 See FBF Letter II at 2 (stating that "[t]he FBF is generally welcoming of the new general EMIR conditions that are introduced as a corollary to the above changes. As applied in the context of trading relationship documentation, trade acknowledgment and verification, they largely convey the manner in which EMIR has been interpreted."); see also SIFMA Letter II at 4.

95 Better Markets Letter at 6.

96 See EMIR articles 2(8) and 2(9).

the relevant EMIR requirements will apply in practice regardless of the counterparty's location or status as "an undertaking". As such, the condition provides that the Covered Entity must comply with the applicable condition of this 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 if not for the counterparty's location and/or lack of 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 apply.[97] By requiring a Covered Entity to treat its counterparty as the type of counterparty that would trigger the application of the relevant EMIR-based requirements, the EMIR-based requirements require the Covered Entity to act in a way that is comparable to Exchange Act requirements. The Commission is modifying the Order to include this condition to ensure that a Covered Entity can apply substituted compliance only when it treats its counterparty as a type that will trigger the Covered Entity's performance of obligations pursuant to those EMIR-based requirements.[98] Because each EMIR-based requirement applies to different types of counterparties, the Commission is amending the condition to make clear that a Covered Entity must treat its counterparty as if the counterparty were the type of counterparty specified in the relevant EMIR-based requirement and that a Covered Entity may not rely on EMIR article 13 to comply with another jurisdiction's requirement.

Another commenter requested that the Commission clarify that this condition would not require a Covered Entity to treat as financial counterparties or non-financial counterparties certain public sector counterparties, such as multilateral development banks, that are exempt

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97 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 directives. The distinction between "financial" and "non-financial" counterparties under EMIR is manifested, inter alia, in connection with confirmation timing standards (see EMIR RTS article 12).

98 See para. (a)(5) of the Order.

from EMIR or counterparties that are not "undertakings" for purposes of EMIR's definitions of "financial counterparty" and "non-financial counterparty."[99] The Commission declines to do so, given that the relevant requirements under the Exchange Act lack analogous carve-outs based on counterparty status. The Commission is, however, clarifying that the condition applies only if the relevant EMIR-based provision applies to the Covered Entity's activities with specified types of counterparties.[100]

The second new general condition accounts for the fact that: (a) 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 a clearing agency that is exempt from registration with the Commission, and (b) the analogous EMIR provisions only apply to over-the-counter derivatives that are not cleared on a CCP (as defined in EMIR article 2(1)). To help ensure that substituted compliance is not precluded in connection with instruments that have been cleared in the EU, this second condition provides that for the applicable EMIR-related conditions, the relevant security-based swap must be an "OTC derivative" or "OTC derivative contract" (as defined under EMIR) that has not been cleared and otherwise is subject to the provisions of the relevant requirements under EMIR, or else that the relevant security-based swap must have been cleared by a central counterparty that has been authorized or recognized by a relevant authority to clear derivatives contracts in the EU.[101]

One commenter requested that the second new general condition be revised to include transactions cleared by <u>any</u> central counterparty – not merely central counterparties authorized or

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99 SIFMA Letter II at 4.

100 <u>See</u> para. (a)(5) of the Order.

101 <u>See</u> para. (a)(6) of the Order. Absent this type of condition, instruments that have been cleared at an EU-authorized or recognized central counterparty neither would be excluded from the application of those Exchange Act rules nor would be subject to the EMIR requirements that otherwise would underpin substituted compliance. That would make direct compliance with the Exchange Act rules problematic, but compliance with the conditions of a positive substituted compliance order unworkable.

recognized by the EU.[102] The commenter stated that in certain circumstances French and EU law permit counterparties to agree to submit certain transactions to third-country central counterparties, and that it would be impractical to require Covered Entities to satisfy Exchange Act requirements that are "principally targeted to non-cleared [security-based swaps] in relation to these transactions."[103] The Commission has modified the condition to clarify that it extends to instruments cleared by central counterparties that have been authorized or recognized by a "relevant authority" in the EU, but the Commission declines to extend it to instruments cleared on "any" central counterparty, as such a standard would provide no safeguard against the risks potentially associated with central counterparties that are not subject to adequate safeguards. In application, the central counterparties described by the provision would extend to those that have been authorized by a competent authority pursuant to EMIR article 14, and those that have been recognized by the European Securities and Markets Authority ("ESMA") pursuant to EMIR article 25.[104]

Finally, the Commission is amending the condition to clarify that the condition applies only if the relevant EMIR-based provision applies to OTC derivatives that have not been cleared by a central counterparty, as some provisions of EMIR cited in the Order, such as EMIR articles 39(4) and (5), are not limited in their application to non-centrally cleared OTC derivatives. Consistent with the condition in paragraph (a)(6) of the Order, the Commission is also adding to the condition references to EMIR RTS and EMIR Margin RTS.

e. Notification requirements related to changes in capital

A commenter requested that the Commission make more granular substituted compliance determinations with respect to the Exchange Act recordkeeping requirements.[105] The commenter

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102 SIFMA Letter II at 4-5.

103 Id. at 4.

104 In light of these considerations, the condition does not extend to clearing permitted pursuant to the equivalence framework of EMIR article 13.

105 See SIFMA Letter I at 8.

stated that for "operational reasons" a Covered Entity may "prefer to comply directly with certain Exchange Act requirements (i.e., not to rely on substituted compliance with those requirements)."[106] The Commission took this approach in the UK Proposed Order with respect to the Exchange Act recordkeeping, reporting, and notification requirements.[107] As part of this approach, the Commission also conditioned substituted compliance with certain of the discrete recordkeeping, reporting, and notification requirements on the Covered Entity applying substituted compliance with respect to the substantive Exchange Act requirement to which they were linked.[108] This linked condition was designed to ensure that a Covered Entity consistently applies substituted compliance with respect to the substantive Exchange Act requirement and the Exchange Act recordkeeping, reporting, or notification requirement that complements the substantive requirement. The Commission sought comment in the Reopening Release on whether it should take a similar granular approach to the Exchange Act recordkeeping, reporting, and notification requirements.[109]

On further consideration and in light of the more granular approach requested by the commenter, the Commission believes it necessary to do the reverse with respect to certain substantive financial responsibility requirements: condition substituted compliance with respect to the substantive requirement on the Covered Entity applying substituted compliance with respect to the linked recordkeeping, reporting, or notification requirement. The Exchange Act financial responsibility requirements addressed in this Order (capital, margin, recordkeeping, reporting, notification, and securities count requirements) are highly integrated. Therefore, implementing the reverse conditional link is designed to ensure that the granular approach requested by the commenter results in comparable regulatory outcomes in terms of obligations to

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106 Id.

107 See UK Substituted Compliance Notice and Proposed Order, 86 FR 18394-403, 18415-420.

108 Id.

109 See Reopening Release, 86 FR at 18347-48.

make and preserve records, and to submit reports and notifications to the Commission concerning the Covered Entity's compliance with the financial responsibility rules. It also is designed to provide clarity as to the obligations of a Covered Entity under this Order when using the granular approach to the Exchange Act recordkeeping, reporting, and notification requirements linked to the financial responsibility rules.

For example, because of the granular approach, a Covered Entity could elect to apply substituted compliance with respect to a substantive Exchange Act requirement such as the capital requirements of Exchange Act rule 18a-1 but elect not to apply substituted compliance with respect to a linked requirement under Exchange Act rule 18a-8 to provide the Commission notice of a capital deficiency under Exchange Act rule 18a-1. In this scenario, the Covered Entity would not be subject to the condition for applying substituted compliance with respect to Exchange Act rule 18a-8; namely, that the firm provide the Commission copies of notifications relating to French and EU capital requirements required under French and EU law. Consequently, as discussed below in this section and other sections of this release, the Commission is conditioning substituted compliance with respect to certain substantive Exchange Act requirements on the Covered Entity applying substituted compliance with respect to linked recordkeeping reporting, or notification requirements.

Exchange Act rule 18a-8(c)

Exchange Act rule 18a-8(c) generally requires every security-based swap dealer with a prudential regulator that files a notice of adjustment of its reported capital category with the Federal Reserve Board, the Office of the Comptroller of the Currency, or the Federal Deposit Insurance Corporation 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).[110] Exchange Act rule 18a-8(h) sets forth the manner in which every notice or report

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[110] See 17 CFR 240.18a-8(c).

required to be given or transmitted pursuant to Exchange Act rule 18a-8 must be made.[111] 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 Board, the Office of the Comptroller of the Currency, or the Federal Deposit Insurance Corporation). Therefore, to implement the granular approach requested by the commenter, the Commission is adding a general condition that Covered Entities with a prudential regulator relying on the final Order for 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).[112]

In their application, the French Authorities cited several French provisions as providing similar outcomes to the notifications requirements of Exchange Act rule 18a-8. Additionally, based on comments received, the Commission has identified additional provisions that are relevant.[113] This general condition is necessary in order to clarify that a prudentially regulated Covered Entity must provide the Commission with copies of any notifications regarding changes in the Covered Entity's capital situation required by French and EU law. In particular, 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 Board, the Office of the Comptroller of the Currency, or the Federal Deposit Insurance Corporation, "compliance" with the provisions of

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111 See 17 CFR 240.18a-8(h).

112 Better Markets Letter at 2-3.

113 These French provisions include: (1) MFC Articles L. 511-33II, L. 634-1, and L. 634-2, which provide, among other things, that the staff of firms may report potential or actual breaches related to certain specified provisions, and provide for the establishment of procedures and secure communication channels through which French regulatory and prudential authorities can be informed of failures to comply with applicable regulations; and (2) Internal Control Order articles 249 and 249-1, which require notification to the ACPR, without delay, of significant incidents with respect to certain thresholds related to the firm's risk analysis and measurement systems, and with respect to operational incidents.

Exchange Act rule 18a-8(c) raises a question as to the Covered Entity's obligations under this Order to provide the Commission with notification of changes in capital.

Moreover, a commenter stated that foreign financial services firms were among the entities that used emergency lending facilities in the U.S. along with other U.S. measures to address the 2008 financial crisis.[114] 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.[115] 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 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).

C. European Union cross-border matters

1. Proposed approach

The proposed Order also included general conditions to address the cross-border application of MiFID and MAR, along with EU and French requirements adopted pursuant to those directives. For some requirements under MiFID (and other EU and Member State requirements adopted pursuant to MiFID), EU law allocates the responsibility for supervising and enforcing those requirements to authorities of the Member State where an entity provides certain services. Similarly, for some requirements under MAR (and other EU and Member State requirements adopted pursuant to MAR), EU law allocates the responsibility for supervising and

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114 Better Markets Letter at 2.

115 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, 25249 (May 2, 2014)).

enforcing those requirements to authorities of potentially multiple Member States. To help ensure that the prerequisites to substituted compliance with respect to supervision and enforcement are satisfied in fact, the proposed Order provided substituted compliance only if one of the authorities responsible for supervision and enforcement of those requirements is the AMF or the ACPR.[116]

2. Commenter views and final provisions

Commenters raised concerns with the proposed approach to European Union cross-border matters. The commenters did not object to the Commission's underlying premise, with one commenter noting that they "[understood] that the Commission has included these conditions in the order to ensure that the prerequisites with respect to supervision and enforcement are satisfied."[117] Commenters instead asserted that the proposed condition would significantly curtail the ability to rely on the Order, with one commenter stating that requiring the AMF or ACPR to be allocated responsibility for the supervision and enforcement of applicable MiFID and MAR provisions, "will in practice lead to an untenable patchwork of substituted compliance."[118] To address these issues, commenters urged the Commission to consider whether it could dispense with certain of the requirements cited in the proposed Order and still make a holistic, outcomes based comparability determination.

The Commission continues to believe that requiring that the AMF or ACPR have responsibility for applicable MiFID and MAR provisions will help ensure that the supervision and enforcement prerequisites to substituted compliance are satisfied.[119] Additionally, the proposed approach helps ensure that applicable MiFID and MAR provisions are interpreted and applied in a consistent manner by entities that are party to the MOUs and/or other arrangements

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116 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85724, 85739.

117 See SIFMA Letter I at 2-8.

118 See SIFMA Letter I at 3.

119 See Business Conduct Adopting Release, 81 FR at 30080; see also id. at 30067.

which are a prerequisite to substituted compliance.[120] In light of these considerations the Commission is issuing the general conditions related to EU cross-border matters largely as proposed.[121] In the Commission's view, these conditions are structured appropriately to permit the use of substituted compliance only when the AMF or the ACPR is the entity responsible for supervising a Covered Entity's compliance with a relevant provision of MiFID, MAR or related EU or French requirements.

The Commission agrees, however, that in light of the EU cross-border implications, further consideration of the specific conditions cited with respect to internal risk management, trade acknowledgement and verification, trading relationship documentation, internal supervision and compliance and recordkeeping, reporting, notification, and securities counts is warranted to ensure that the scope of substituted compliance is appropriate. The Commission addresses those specific requirements below.[122]

This part of the Order has been modified from the proposed Order to incorporate references to conditions requiring compliance with MiFIR, given that certain relevant MiFIR conditions to substituted compliance are subject to the same principles regarding the allocation of authority.[123]

IV. Substituted Compliance for Risk Control Requirements

A. Proposed approach

The French Authorities' Application in part requested substituted compliance in connection with risk control requirements relating to:

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120 See id. at 30087.

121 See para. (a)(8) of the Order.

122 See also discussion in part III.B.2.d.

123 MiFID article 35(8) particularly provides that these allocation principles apply in connection with MiFIR articles 14 to 26. The Commission requested comment on the addition of MiFIR and received no comment.

- Internal risk management – Internal risk management system requirements that address the obligation of registered entities to follow policies and procedures reasonably designed to help manage the risks associated with their business activities.
- Trade acknowledgment and verification – Trade acknowledgment and verification requirements intended to help avoid legal and operational risks by requiring definitive written records of transactions and procedures to avoid disagreements regarding the meaning of transaction terms.
- Portfolio reconciliation and dispute reporting – Portfolio reconciliation and dispute reporting provisions that require that counterparties engage in portfolio reconciliation and resolve discrepancies in connection with uncleared security-based swaps, and to provide prompt notification to the Commission and applicable prudential regulators regarding certain valuation disputes.
- Portfolio compression – Portfolio compression provisions that require that SBS Entities have procedures addressing bilateral offset, bilateral compression and multilateral compression in connection with uncleared security-based swaps.
- Trading relationship documentation – Trading relationship documentation provisions that require SBS Entities to have procedures to execute written security-based swap trading relationship documentation with their counterparties prior to, or contemporaneously with, executing certain security-based swaps.[124]

Taken as a whole, these risk control requirements help to promote market stability by mandating that registered entities follow practices that are appropriate to manage the market, counterparty, operational, and legal risks associated with their security-based swap businesses.

In considering conditional substituted compliance for the risk control portion of the French Authorities' Application, the Commission preliminarily concluded that the relevant

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[124] See French Substituted Compliance Notice and Proposed Order, 85 FR at 85724.

French and EU requirements generally would help to produce regulatory outcomes that are comparable to those under the Exchange Act by subjecting Covered Entities to risk mitigation and documentation practices that are appropriate to the risks associated with their security-based swap businesses.[125] Substituted compliance under the proposed Order was to be conditioned in part on Covered Entities being subject to and complying with the specified French and EU provisions that in the aggregate help to produce regulatory outcomes that are comparable to those associated with the risk control requirements under the Exchange Act.[126]

Substituted compliance under the proposed Order also was to be subject to certain additional conditions to help ensure the comparability of outcomes: (a) substituted compliance in connection with the trading relationship documentation provisions would be conditioned on the requirement that the Covered Entity not treat its counterparties as "eligible counterparties" for purposes of relevant MiFID provisions[127]; (b) substituted compliance related to trading relationship documentation under the proposed Order would not extend to certain disclosures regarding legal and bankruptcy status[128]; and (c) substituted compliance in connection with portfolio reconciliation and dispute reporting requirements would be conditioned on the Covered Entity having to provide the Commission with reports regarding disputes between counterparties on the same basis as they provide those reports to competent authorities pursuant to EU law.[129]

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125 Id. at 85724.

126 Id. at 85724 n.37.

127 Id. at 85725. Certain relevant French and EU requirements that provide for this type of documentation do not apply to investment firms' transactions with "eligible counterparties."

128 Id. The trading relationship documentation provisions of rule 15F(b)(5) require certain disclosures regarding the status of the SBS Entity or its counterparty as an insured depository institution or financial counterparty, and regarding the possible application of the insolvency regime set forth under Title II of the Dodd-Frank Act or the Federal Deposit Insurance Act. Documentation requirements under applicable French and EU law would not be expected to address the disclosure of information related to insolvency procedures under U.S. law.

129 Id. Under the Exchange Act requirement, SBS Entities must promptly report, to the Commission, valuation disputes in excess of $20 million that have been outstanding for three or five business days (depending on counterparty types). EU requirements provide that firms must report at least monthly, to competent authorities, disputes between counterparties in excess of €15 million and outstanding for at least 15 business days.

B. Commenter views and final provisions

Commenters initially expressed the view that the Commission should modify certain of the proposed conditions related to substituted compliance in connection with internal risk management, trade acknowledgement and verification, and trading relationship documentation requirements.[130] Specifically, commenters expressed concerns with proposed MiFID requirements for trade acknowledgement and verification and trading relationship documentation that "cover the same ground" as proposed EMIR requirements and "would result in undue burdens for French [security-based swap dealers]."[131] Partially in light of those concerns, the Commission reopened the comment period and solicited additional comment on whether EMIR requirements standing alone could produce comparable results such that certain MiFID provisions may be removed as prerequisites to substituted compliance for trade acknowledgement and verification and trading relationship documentation requirements.[132] Certain commenters generally supported changes contemplated by the Commission in the Reopening Release.[133] Another commenter stated that French and EU requirements are not sufficiently comparable to Exchange Act requirements.[134]

After considering commenters' recommendations regarding the risk control requirements, the Commission is making positive substituted compliance determinations in connection with internal risk management, trade acknowledgment and verification, portfolio reconciliation and dispute reporting, portfolio compression and trading relationship documentation requirements.

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130 See SIFMA Letter I at 4-6; FBF Letter I at 2.

131 See FBF Letter I at 2. See also SIFMA Letter I at 3 (noting that the application of certain proposed MiFID and EMIR rules would "lead to an untenable patchwork of substituted compliance.")

132 See Reopening Release, 86 FR at 18343.

133 See SIFMA Letter II at 6 (stating that "[w]e generally support these proposed modifications to the French Order"); see also FBF Letter II at 2. But see Better Markets Letter at 6 ("It is understandable that industry groups would urge the SEC to make it easier for more members of the industry to avail themselves of the privilege of substituted compliance. . . . However, easing regulatory burdens for the industry is not the SEC's job.").

134 See Better Markets Letter at 1-2.

As discussed below, the final Order has been changed from the proposed Order in certain respects in response to comments following the proposed Order and Reopening Release. The Commission continues to conclude that, taken as a whole, applicable requirements under French and EU law subject Covered Entities to risk mitigation and documentation practices that are appropriate to the risks associated with their security-based swap businesses, and thus help to produce regulatory outcomes that are comparable to the outcomes associated with the relevant risk control requirements under the Exchange Act. Although the Commission recognizes that there are differences between the approaches taken by the relevant risk control requirements under the Exchange Act and relevant French and EU requirements, the Commission continues to believe that those differences on balance should not preclude substituted compliance for these requirements, as the relevant French and EU requirements taken as a whole help to produce comparable regulatory outcomes.

To help ensure the comparability of outcomes, substituted compliance for risk control requirements is subject to certain conditions. Substituted compliance for internal risk management, trade acknowledgment and verification, portfolio reconciliation and dispute reporting, portfolio compression and trading relationship documentation requirements is conditioned on the Covered Entity being subject to, and complying with, relevant French and EU requirements.[135] In addition, consistent with the proposed Order, substituted compliance for trading relationship documentation does not extend to disclosures regarding legal and bankruptcy status that are required by Exchange Act rule 15Fi-5(b)(5) when the counterparty is a U.S. person.[136] Finally, consistent with the proposed Order, substituted compliance for portfolio

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135 See paras. (b)(1) through (5) of the Order.

136 See para. (b)(5) of the Order. The Exchange Act rule 15Fi-5, 17 CFR 240.15Fi-5, disclosures address information regarding: (1) the status of the SBS Entity or its counterparty as an insured depository institution or financial counterparty, and (2) the possibility that in certain circumstances the SBS Entity or its counterparty may be subject to the insolvency regime set forth in Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act or the Federal Deposit Insurance Act, which may affect rights to terminate, liquidate or net security-based swaps. See Exchange Act Release No. 87782 (Dec. 18, 2019), 85 FR 6359, 6374 (Feb. 4,

reconciliation and dispute reporting requirements is conditioned on the Covered Entity providing the Commission with reports regarding disputes between counterparties on the same basis as the Covered Entity provides those reports to its competent authority pursuant to French and EU law.[137] A Covered Entity that is unable to comply with an applicable condition—and thus is not eligible to use substituted compliance for the particular set of Exchange Act risk control requirements related to that condition—nevertheless may use substituted compliance for another set of Exchange Act requirements addressed in the Order if it complies with the conditions to the relevant parts of the Order.

Under the Order, substituted compliance for risk control requirements (relating to internal risk management, trade acknowledgment and verification, portfolio reconciliation and dispute reporting, portfolio compression and trading relationship documentation) is not subject to a

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2020) ("Risk Mitigation Adopting Release"). Documentation requirements under applicable French and EU law do not address the disclosure of information related to insolvency procedures under U.S. law. However, the absence of such disclosures would not appear to preclude a comparable regulatory outcome when the counterparty is not a U.S. person, as the insolvency-related consequences that are the subject of the disclosure would not apply to non-U.S. counterparties in most cases. Moreover, EMIR Margin RTS article 2 requires counterparties to establish, apply and document risk management procedures providing for or specifying the terms of agreements entered into by the counterparties, including applicable governing law for non-centrally cleared derivatives. When counterparties enter into a netting or collateral exchange agreement, they also must perform an independent legal review of the enforceability of those agreements.

137 See paras. (b)(3)(ii) of the Order. This condition promotes comparability with the Exchange Act rule requiring reports to the Commission regarding significant valuation disputes, while leveraging French and EU reporting provisions to avoid the need for Covered Entities to create additional reporting frameworks. When it proposed the condition to report valuation disputes, the Commission recognized that valuation inaccuracies may lead to uncollateralized credit exposure and the potential for loss in the event of default. See Exchange Act Release No. 84861 (Dec. 19, 2018), 84 FR 4614, 4621 (Feb. 15, 2019). It thus is important that the Commission be informed regarding valuation disputes affecting SBS Entities. The principal difference between the Exchange Act and French and EU valuation dispute reporting requirements concerns the timing of notices. Exchange Act rule 15Fi-3, 17 CFR 240.15Fi-3, requires SBS Entities to report promptly to the Commission valuation disputes in excess of $20 million that have been outstanding for three or five business days (depending on the counterparty type). EMIR RTS article 15(2) requires financial counterparties to report to the relevant competent authority at least monthly any disputes between counterparties in excess of €15 million and outstanding for at least 15 business days. The Commission is mindful that the French and EU provision does not provide for notice as quickly as rule 15Fi-3, but in the Commission's view on balance this difference would not be inconsistent with the conclusion that the two sets of requirements, taken as a whole, promote comparable regulatory outcomes.

condition that the Covered Entity apply substituted compliance for related recordkeeping requirements in Exchange Act rules 18a-5 and 18a-6. A Covered Entity that applies substituted compliance for one or more risk control requirements, but does not apply substituted compliance for the related recordkeeping requirements in Exchange Act rules 18a-5 and 18a-6, will remain subject to the relevant provisions of Exchange Act rules 18a-5 and 18a-6. Those rules require the Covered Entity to make and preserve records of its compliance with Exchange Act risk control requirements and of its security-based swap activities required or governed by those requirements. A Covered Entity that applies substituted compliance for a risk control requirement, but complies directly with related recordkeeping requirements in rules 18a-5 and 18a-6, therefore must make and preserve records of its compliance with the relevant conditions of the Order and of its security-based swap activities required or governed by those conditions and/or referenced in the relevant parts of rules 18a-5 and 18a-6.

1. Internal risk management

Exchange Act section 15F(j)(2) requires a registered SBS Entity to establish robust and professional risk management systems adequate for managing its day-to-day business. In addition, Exchange Act rule 15Fh-3(h)(2)(iii)(I) requires an SBS Entity to establish and maintain a system to supervise, and to diligently supervise, its business and the activities of its associated persons. This system of internal supervision must include, in relevant part, the establishment, maintenance and enforcement of written policies and procedures reasonably designed, taking into consideration the nature of the SBS Entity's business, to comply with its duty under Exchange Act section 15F(j)(2) to establish an internal risk management system.

Under the proposed Order, substituted compliance in connection with internal risk management requirements would have been conditioned on Covered Entities being subject to and complying with certain MiFID, CRD and EMIR requirements related to internal risk management. One commenter expressed the view that the scope of this proposed condition would require SBS Entities to be subject to and comply with "an expansive range of detailed and

prescriptive requirements" that are not necessary to produce comparable regulatory outcomes.[138] The commenter further criticized conditions requiring compliance with certain internal risk management requirements prescribed by the CRD, stating that those prescriptive requirements go beyond the "high-level" internal risk management requirements set forth by Exchange Act section 15F(j)(2).[139] The commenter also expressed the view that the conditions should not extend to the compliance system requirements of MiFID Org Reg article 22, on the grounds that compliance system requirements do not relate to risk management.[140] Commenters reiterated these same concerns following the reopening of the comment period, requesting the removal of specific MiFID, MFC, MiFID Org Reg, CRD, CRR, Prudential Supervision and Risk Assessment Order, and EMIR Margin RTS requirements for internal risk management.[141] By contrast, another commenter requested that the Commission "not weaken [the risk control] conditions any further."[142]

The proposed Order included CRD articles 79 through 87, MiFID articles 16(4) and (5), CRR articles 286 through 288 and 293, EMIR Margin RTS article 2, MiFID Org Reg articles 21, 22 and 24, and the implementing provisions of French law. A commenter stated that the Commission should delete those provisions because they do not correspond to and go beyond Exchange Act internal risk management requirements.[143] However:

- CRD article 79 and the implementing provisions of French law address a Covered Entity's management of credit and counterparty risk. CRD article 80 and the implementing provisions of French law address a Covered Entity's management of residual risk. CRD article 81 and the implementing provisions of French law

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138 SIFMA Letter I at 4-5.

139 Id. at 5.

140 Id.

141 SIFMA Letter II at Appendix A; FBF Letter II at 2.

142 Better Markets Letter at 2.

143 SIFMA Letter II at Appendix A.

address a Covered Entity's management of concentration risk. CRD article 82 and the implementing provisions of French law address a Covered Entity's management of securitization risk. CRD article 83 and the implementing provisions of French law address a Covered Entity's management of market risk. CRD article 84 and the implementing provisions of French law address a Covered Entity's management of interest rate risk. CRD article 85 and the implementing provisions of French law address a Covered Entity's management of operational risk. CRD article 86 and the implementing provisions of French law address a Covered Entity's management of liquidity risk and funding risk. CRD article 87 and the implementing provisions of French law address a Covered Entity's management of risk from excessive leverage.

- MiFID article 16(4) and the implementing provisions of French law require a Covered Entity to take reasonable steps to ensure continuity and regularity in the in the performance of investment services and activities, including by employing appropriate and proportionate systems, resources and procedures. MiFID article 16(5) and the implementing provisions of French law require a Covered Entity to ensure that it manages the operational risk of relying on third parties for the performance of operational functions that are critical to the continuous and satisfactory provision of service to clients and performance of investment services and activities.
- CRR article 286 requires a Covered Entity to establish and maintain a counterparty credit risk management framework, including policies, processes and systems to ensure the identification, measurement, approval and internal reporting of counterparty credit risk and procedures for ensuring that those policies, processes and systems are complied with. CRR article 287 addresses the internal governance of risk control and collateral management functions for Covered

Entities that use internal models to calculate capital requirements. CRR article 288 requires the Covered Entity to conduct regular, independent reviews of its counterparty credit risk management systems and any risk control and collateral management functions required by CRR article 287. CRR article 293 addresses internal governance of the Covered Entity's internal risk management systems and validation of risk models that the Covered Entity uses.

- EMIR Margin RTS article 2 requires counterparties to non-centrally cleared OTC derivative contracts to establish, apply and document risk management procedures for the exchange of collateral.
- MiFID Org Reg article 21 addresses a Covered Entity's systems, internal controls and arrangements for management of a variety of risk areas, including internal decision-making, allocation and proper discharge of responsibilities, compliance with decisions and internal procedures, employment of personnel able to discharge their responsibilities, internal reporting and communication of information, adequate and orderly recordkeeping, safeguarding information, business continuity, accounting policies and procedures, as well as regular evaluation of the adequacy and effectiveness of those systems, internal controls and arrangements. MiFID Org Reg article 22 addresses a Covered Entity's policies and procedures for detecting and minimizing risk of failure to comply with its obligations under EU provisions that implement MiFID, as well as the Covered Entity's independent compliance function that monitors and assesses the adequacy and effectiveness of those policies and procedures. MiFID Org Reg article 24 addresses a Covered Entity's internal audit function that evaluates the adequacy and effectiveness of the Covered Entity's systems, internal controls and arrangements.

Each of these requirements helps to produce regulatory outcomes comparable to Exchange Act requirements to establish robust and professional internal risk management systems adequate for managing the Covered Entity's day-to-day business. The comparability analysis requires consideration of Exchange Act requirements as a whole against analogous French and EU requirements as a whole, recognizing that U.S. and non-U.S. regimes may follow materially different approaches in terms of specificity and technical content. This "as a whole" approach – which the Commission is following in lieu of requiring requirement-by-requirement similarity – further means that the conditions to substituted compliance should encompass all French and EU requirements that establish comparability with the applicable regulatory outcome, and helps to avoid ambiguity in the application of substituted compliance. It would be inconsistent with the holistic approach to excise relevant requirements and leave only the residual French and EU provisions that most closely resemble the analogous Exchange Act requirements.[144] Accordingly, the Commission is retaining the references to these provisions. Retaining conditions of the Order necessary to help produce regulatory outcomes comparable to Exchange Act internal risk management requirements also should address another commenter's concern that any substituted compliance determination not weaken the risk control conditions in the proposed Order.[145]

The Commission is making three changes from the proposed Order for this portion of the Order. First, the Commission concurs with a commenter recommendation that the prerequisites to substituted compliance for internal risk management should not extend to the Covered Entity being subject to and complying with French Prudential Supervision and Risk Assessment Order article 7, which does not impose obligations on regulated entities.[146] Second, the Commission is

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144 The Commission further believes that those conditions to substituted compliance do not expand the scope of Exchange Act requirements because substituted compliance is an option available to non-U.S. person SBS Entities – not a mandate.

145 See Better Markets Letter at 1-2.

146 SIFMA Letter II at Appendix A.

incorporating, as part of the relevant conditions a Covered Entity using substituted compliance for internal risk management must be subject to and comply with, MFC L. 533-2, which is the French implementation of the internal risk management requirements set forth in the second paragraph of MiFID article 16(5).[147] Finally, the Commission is incorporating, as part of the relevant conditions, MiFID articles 16 and 23 and the related implementing provisions;[148] MiFID Org Reg articles 25 through 37, 72 through 76 and Annex IV; and CRD articles 88(1), 91(1) and (2), and (7) through (9), 92, 94, and 95 and the related implementing provisions.[149] 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.

In deciding to make a positive substituted compliance determination for French and EU internal risk management requirements, the Commission considers that the Order's condition requiring a Covered Entity to be subject to and comply with all of the French and EU internal risk management requirements listed in paragraph (b)(1) of the Order help to produce regulatory outcomes comparable to Exchange Act internal risk management requirements. The Commission recognizes that some of the French and EU requirements related to risk management follow a more granular approach than the high-level approach of Exchange Act internal risk management requirements, but these French and EU requirements, taken as a whole, are crafted to promote a Covered Entity's risk management. Within the requisite outcomes-oriented approach for analyzing comparability, the Commission concludes that a Covered

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147 That cross-reference inadvertently was omitted from the proposed Order, but was incorporated within the proposed conditions related to internal supervision and compliance (see para. (d)(3) of the Order), and was cited by the French Authorities' Application as supporting comparability in connection with internal risk management system requirements (see French Authorities' Application at 68).

148 MFC articles L. 533-10.II (1) through (3) and (6) through (9), L. 533-10.III, L. 533-24 and L. 533-24-1.

149 MFC articles L. 511-51, L. 511-52.I, L. 511-53, L. 511-58, L. 511-59, L. 511-67 through L. 511-69, L. 511-71 through L. 511-85, L. 511-102, R. 511-18-2 and R. 511-16-3.

Entity's failure to comply with any of those French and EU internal risk management requirements would be inconsistent with a Covered Entity's obligation under Exchange Act internal risk management requirements.[150] In contrast to the assertion that such provisions "go beyond the general requirements of Exchange Act section 15(j)(2),"[151] the Commission concludes that compliance with the full set of French and EU internal risk management requirements listed in paragraph (b)(1) of the Order would promote comparable regulatory outcomes.

2. Trade acknowledgement and verification

Under the proposed Order, substituted compliance in connection with the Exchange Act rule 15Fi-2 trade acknowledgment and verification requirement would have been conditioned on firms having to comply with relevant confirmation requirements under MiFID and EMIR. Commenters expressed the view that the conditions should not incorporate MiFID confirmation provisions, based in part on the view that EMIR requirements standing alone would be sufficient to produce regulatory outcomes comparable to those under Exchange Act trade acknowledgement and verification requirements.[152] One commenter further stated that conditioning substituted compliance on SBS Entities having to comply with MiFID confirmation requirements in practice would undermine the availability of substituted compliance for SBS

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150 One commenter recognized that the application addressed CRD requirements in connection with internal risk management requirements, but expressed the view that those discussions address comparability in connection with Exchange Act rule 18a-1(f), relating to risk management systems in connection with capital requirements. See SIFMA Letter I at 5 n.9. Regardless of applicants' rationale for citing those CRD requirements as supporting comparability, the Commission believes that the appropriate comparability analysis generally should seek to compare regulatory regimes taken as a whole, and that a Covered Entity's failure to comply with the applicable CRD risk management system requirements would not lead to a regulatory outcome consistent with that established by Exchange Act internal risk management requirements.

151 SIFMA Letter II at Appendix A.

152 See SIFMA Letter I at 5-6; FBF Letter I at 2; EBF Letter I (providing general support for SIFMA Letter I).

Entities that have branches in EU member states for which the Commission has not entered into an applicable substituted compliance memorandum of understanding.[153]

When the Commission reopened the comment period, it solicited additional comment on whether EMIR requirements were sufficient to produce comparable results, such that MiFID provisions may be removed as conditions to substituted compliance for trade acknowledgement and verification.[154] Some commenters generally supported the associated changes contemplated by the Commission in the Reopening Release.[155] On the other hand, one commenter stated its opinion that "some industry participants may not be able to take advantage of substituted compliance under the SEC's proposed framework is not, in and of itself, a reason to change the framework".[156] The same commenter stated that "the French regulatory framework governing [trade acknowledgement]… does not satisfy the test for substituted compliance" and that "the Commission should certainly not weaken [the trade acknowledgment] conditions any further."[157]

The Commission agrees that, in and of itself, the fact that some may not be able to rely on the Order is not a sufficient reason to modify the Order. On the other hand, the Commission believes that the duplicative nature of the MiFID-related conditions and the EMIR-related conditions in light of the implementation issues warrants the removal of the MiFID-related conditions, and the Order has been modified accordingly.[158] In taking this step, the Commission has considered French and EU timely confirmation requirements. EMIR article 11 requires "financial counterparties" and "non-financial counterparties" to ensure appropriate procedures

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153 See SIFMA Letter I at 2-4.

154 See Reopening Release, 86 FR at 18343.

155 See SIFMA Letter II at 6-7 (stating that the EMIR requirements "are sufficient, standing alone, to reach comparable outcomes" to the Exchange Act trade acknowledgement and verification (and trading relationship documentation) requirements, and that "further requiring compliance with MiFID documentation requirements would substantially reduce the overall availability of substituted compliance in these areas because those MiFID requirements are not necessarily applicable on an entity-wide basis like the EMIR requirements are"); see also FBF Letter II at 2.

156 Better Markets Letter at 2.

157 Id.

158 See para. (b)(2) of the Order.

and arrangements are in place to achieve timely confirmation of the terms of an OTC derivative contract.[159] Similarly, EMIR RTS article 12 requires non-centrally cleared OTC derivative contracts between "financial counterparties" and "non-financial counterparties" to be confirmed.[160] These counterparty categories do not include entities organized outside the EU, such as U.S. persons.[161] Confirmation means the documentation of the agreement of the counterparties to all the terms of the OTC derivative contract.[162] The French and EU requirements as a whole thus require a Covered Entity[163] to provide a confirmation that serves as a trade acknowledgment, without regard to where its counterparty is organized, and also require the Covered Entity's counterparty, when it is a financial counterparty or non-financial counterparty, to provide a confirmation that serves as the trade verification, and the Commission considers these requirements to promote regulatory outcomes comparable to Exchange Act trade acknowledgment and verification requirements for those counterparties. The French and EU requirements in most instances do not require a Covered Entity's counterparty that is organized outside the EU to provide a French confirmation that serves as a trade verification[164], though

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159 See EMIR article 11(1)(a).

160 See EMIR RTS articles 12(1) and (2).

161 See EMIR article 2(8) (definition of "financial counterparty"); EMIR article 2(9) (definition of "non-financial counterparty").

162 See EMIR RTS article 1(c).

163 The Order defines a Covered Entity to include an investment firm or credit institution authorized by the ACPR. Investment firms and credit institutions are included in the definition of "financial counterparty," so a Covered Entity is also a financial counterparty and thus is "subject to" EMIR article 11 and related provisions of EMIR RTS and EMIR Margin RTS for purposes of the Order.

164 See EMIR article 2(8) (definition of "financial counterparty" limited to entities defined or authorized in a manner that in most instances is reserved for EU-established entities); EMIR article 2(9) (definition of "non-financial counterparty" limited to EU-established entities); EMIR articles 11(1)(a) and 11(12) (confirmation requirement applies to financial counterparties, non-financial counterparties and third-country entities that would be subject to the confirmation requirement if established in the EU and either the relevant contract has a direct, substantial and foreseeable effect in the EU or the obligation is necessary or appropriate to prevent the evasion of any provision of EMIR).

they do require the Covered Entity to confirm the transaction.[165] Confirmation is defined as documenting the agreement of the Covered Entity and its counterparties to all the terms of the OTC derivative contract.[166] To ensure that a Covered Entity using substituted compliance for trade acknowledgment and verification requirements will be required to document the agreement of the counterparties to all the terms of the relevant transaction, the Commission is issuing the Order with two new general conditions that will require the Covered Entity to treat its counterparty as a financial counterparty or non-financial counterparty when complying with French and EU trade acknowledgment and verification requirements and to ensure that the relevant security-based swap is either non-centrally cleared and subject to EMIR or cleared by a

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165 As defined in paragraph (g)(1) of the Order, a Covered Entity must be an investment firm or credit institution authorized by the ACPR to provide investment services or perform investment activities in the French Republic. These investment firms and credit institutions are limited to French-established entities and do not include third-country firms. See MiFID article 4(57) (definition of "third-country firm" is a firm that would be a credit institution providing investment services or performing investment activities or an investment firm if its registered office or head office were located in the EU); MFC article L. 532-47 (same). Each of these investment firms and credit institutions also is among the entities that qualify as a "financial counterparty." See EMIR article 2(8) (definition of "financial counterparty" includes credit institutions and investment firms).

166 See EMIR RTS article 1(c). In other words, the Covered Entity would be subject to the relevant requirements under EMIR even if the counterparty is not authorized pursuant to EU law as anticipated by the EMIR article 2(8) "financial counterparty" definition or 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), as anticipated by the EMIR article 2(9) "non-financial counterparty" definition. This approach appears to be consistent with EU 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) 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).

central counterparty that has been authorized or recognized to clear derivatives contracts by a relevant authority in the EU.[167]

Another commenter recommended removal of conditions requiring compliance with EMIR RTS article 12(4) because it does not relate to and goes beyond Exchange Act trade acknowledgment and verification requirements.[168] As part of the French and EU framework for trade acknowledgment and verification, EMIR RTS article 12(4) requires a Covered Entity to have the necessary procedures to report on a monthly basis to the competent authority the number of unconfirmed, non-centrally cleared OTC derivative transactions that have been outstanding for more than five business days. Though Exchange Act rule 15Fi-2 does not have a similar requirement to report unconfirmed trades, the Commission considers that EMIR RTS article 12(4)'s requirement to report unconfirmed trades to the competent authority is an inseparable part of the French and EU framework for trade acknowledgment and verification, as those reports support the framework's mandate to confirm transactions. Requiring a Covered Entity to be subject to and comply with EMIR RTS article 12(4) thus is consistent with a holistic approach for comparing regulatory outcomes that reflects the whole of a jurisdiction's relevant requirements. Accordingly, the Order retains as a condition to substituted compliance for trade acknowledgment and verification requirements the requirement that the Covered Entity be subject to and comply with the entirety of EMIR RTS article 12.

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167 See paras. (a)(5) and (a)(6) of the Order; see also part III.B, supra. Commenters supported those additions. See FBF Letter II at 2 (stating that "[t]he FBF is generally welcoming of the new general EMIR conditions that are introduced as a corollary to the above changes. As applied in the context of trading relationship documentation, trade acknowledgment and verification, they largely convey the manner in which EMIR has been interpreted."). See also SIFMA Letter II at 6 (stating that "we agree with the Commission that the cited provisions of EMIR are comparable to the Exchange Act trade acknowledgment and verification and trading relationship documentation requirements.").

168 See SIFMA Letter II at Appendix A (stating that the requirements of the rule, which relate to the obligation of financial counterparties to report, on a monthly basis, the number of unconfirmed OTC derivative transactions that have been outstanding for more than five business days, "do not correspond to and go beyond the general requirements of" rule 15Fi-2).

In summary, the Commission believes that French and EU requirements promote the goal of avoiding legal and operational risks by requiring definitive written records of transactions and procedures to avoid disagreements regarding the meaning of transaction terms, in a manner that is comparable to the purpose of Exchange Act rule 15Fi-2.[169] The Commission recognizes that the MiFID confirmation requirements, particularly MiFID Org Reg article 59, are more specific regarding relevant categories of information to be disclosed (in the context of a one-way requirement for firms to provide reports to their clients), but does not believe that those additional one-way confirmation provisions are necessary to achieve the policy goal of avoiding legal and operational risks. While the Commission recognizes the differences between French and EU requirements and Exchange Act trade acknowledgment and verification requirements, in the Commission's view those differences on balance would not preclude substituted compliance, particularly as requirement-by-requirement similarity is not needed for substituted compliance. The Commission is not persuaded by a commenter view that "denying substituted compliance under the applicable circumstances seems perfectly reasonable," given the Commission's conclusion that the relevant EMIR-related conditions provide regulatory outcomes that are comparable to those associated with the Exchange Act requirement, and the regulatory efficiency benefits associated with substituted compliance.[170] That commenter's request for a "robust, evidence-based analysis" has been met here in the context of the requisite holistic analysis,[171]

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169 The two new EMIR-related general conditions addressed above should further help ensure that the EMIR confirmation provisions comprehensively apply to relevant non-cleared transactions of SBS Entities.

170 Better Markets Letter at 6.

171 See Better Markets Letter at 6 (alluding to the need for a "robust, evidence-based analysis"). As discussed above (see part II.D.2, supra), the Commission believes that the present approach toward comparability analyses – which are based on a close reading of relevant foreign requirements and careful consideration of regulatory outcomes – appropriately reflects the holistic comparability approach and the rejection of requirement-by-requirement similarity.

and the commenter's suggestion that there is a need for analysis regarding protection of the American financial system has been addressed above.[172]

3. Portfolio reconciliation and dispute reporting

In the French Substituted Compliance Notice and Proposed Order, the Commission proposed to make a positive substituted compliance determination conditioned on the Covered Entity being subject to and complying with specific French portfolio reconciliation and dispute reporting requirements.[173] One commenter expressed general support for the proposed approach toward substituted compliance for the risk control provisions.[174] Another commenter stated that, if the Commission makes a positive substituted compliance determination, it must at a minimum ensure that it does "not weaken [the] conditions any further."[175] The Commission continues to believe that French portfolio reconciliation and dispute reporting requirements promote regulatory outcomes comparable to Exchange Act requirements, by subjecting Covered Entities to risk mitigation practices that are appropriate to the risks associated with their security-based swap businesses, and is making a positive substituted compliance determination for portfolio reconciliation and dispute reporting requirements consistent with the proposed Order.[176] Substituted compliance in connection with the dispute reporting requirements is conditioned in part on the Covered Entities providing the Commission with reports regarding disputes between counterparties on the same basis as the entities provide those reports to competent authorities pursuant to EU law, to allow the Commission to obtain notice regarding key information in a manner that makes use of existing obligations under EU law.[177]

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172 See Better Markets Letter at 6 (stating that the Commission must provide analysis that the change would protect the American financial system). See also discussion in part II.D.2 supra).

173 French Substituted Compliance Notice and Proposed Order, 85 FR at 85740.

174 See SIFMA Letter II at 6.

175 See Better Markets Letter at 2.

176 See para. (b)(3) of the Order.

177 See para. (b)(3)(ii) of the Order. The Commission recognizes the differences between the two sets of requirements – under which Exchange Act rule 15Fi-3 requires SBS Entities to report

4. Portfolio compression

In the French Substituted Compliance Notice and Proposed Order, the Commission proposed to make a positive substituted compliance determination conditioned on the Covered Entity being subject to and complying with specific French portfolio compression requirements.[178] One commenter expressed general support for the proposed approach toward substituted compliance for the risk control provisions.[179] Another commenter stated that, if the Commission makes a positive substituted compliance determination, it must at a minimum ensure that it does "not weaken [the] conditions any further."[180] The Commission continues to believe that French portfolio compression requirements promote regulatory outcomes comparable to Exchange Act requirements, by subjecting Covered Entities to risk mitigation practices that are appropriate to the risks associated with their security-based swap businesses, and is making a positive substituted compliance determination for portfolio compression requirements consistent with the proposed Order.[181]

5. Trading relationship documentation

Under the proposed Order, substituted compliance in connection with the Exchange Act rule 15Fi-5 trading relationship documentation requirement would have been conditioned on Covered Entities being subject to and complying with MiFID and EMIR provisions that address records regarding counterparty relationships and entities.[182] Substituted compliance under the

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valuation disputes in excess of $20 million that have been outstanding for three or five business days (depending on counterparty types), while EMIR RTS art. 15(2) requires firms to report disputes between counterparties in excess of €15 million and outstanding for at least 15 business days. In the Commission's view, the two requirements produce comparable regulatory outcomes notwithstanding those differences.

178 French Substituted Compliance Notice and Proposed Order, 85 FR at 85740.

179 See SIFMA Letter II at 6.

180 See Better Markets Letter at 2.

181 See para. (b)(4) of the Order.

182 See para. (b)(5) of the proposed Order.

proposed Order would not extend to rule 15Fi-5(b)(5) insolvency-related disclosures when the counterparty is a U.S. person.[183]

Consistent with the comments addressed above with respect to trade acknowledgement and verification, some commenters requested that substituted compliance for trading relationship documentation not incorporate conditions requiring compliance with MiFID documentation requirements.[184] Those commenters expressed the view that compliance with MiFID requirements would not be feasible for Covered Entities that have branches in third countries, and that the EMIR risk management provisions connected to the exchange of collateral are sufficient to produce regulatory outcomes comparable to those under the Exchange Act trading relationship documentation rule.[185]

As noted above, the Commission reopened the comment period and solicited additional comment on whether EMIR requirements standing alone could produce comparable results such that certain MiFID provisions may be removed as prerequisites to substituted compliance.[186] Some commenters generally supported the associated changes contemplated by the Commission in the Reopening Release[187] (including the addition of two new EMIR-related general conditions addressed above),[188] while one commenter opposed removal of the MiFID conditions.[189] The Commission concludes that the implementation issues raised by commenters warrant removal of the MiFID-related condition, and that compliance with EMIR-based risk management requirements are sufficient to produce risk-mitigating outcomes that are comparable to those associated with the Exchange Act rule. The Order accordingly has been modified from the

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183 French Substituted Compliance Notice and Proposed Order, 85 FR at 85725.

184 See SIFMA Letter I at 6.

185 See SIFMA Letter I at 3-4.

186 See part III.B, supra.

187 See SIFMA Letter II at 6; see also FBF Letter II at 2.

188 See part III.B.2.d, supra.

189 See Better Markets Letter at 6-7.

proposed Order to remove conditions requiring compliance with MiFID trading relationship documentation requirements, including corollary conditions related to the application of the MiFID to "eligible counterparties."[190] In reaching this conclusion, the Commission highlights the special importance of EMIR Margin RTS article 2, which addresses 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). Those obligations are denoted as being connected to collateral exchange obligations, and the Commission believes that they are necessary to help produce a regulatory outcome that mitigates risk in a manner that is comparable to the outcome associated with the Exchange Act trading relationship documentation rule. To bridge any gap left by EMIR Margin RTS article 2, the Commission is also requiring compliance with EMIR article 11(1)(a) and EMIR RTS article 12, which require the Covered Entity to confirm the transaction, with confirmation defined as documentation of the agreement of the counterparties to all the terms of the OTC derivative contract.[191]

To ensure that a Covered Entity using substituted compliance for trading relationship documentation requirements will be required to document the agreement of the counterparties to all the terms of the relevant transaction, the Commission is issuing the Order with two new general conditions that will require the Covered Entity to treat its counterparty as a financial counterparty or non-financial counterparty when complying French and EU trading relationship documentation requirements and to ensure that the relevant security-based swap is either non-

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190 See para. (b)(5) of the Order. Consistent with the proposed Order, substituted compliance in connection with trading relationship documentation requirements does not extend to Exchange Act rule 15Fi-5(b)(5) provisions related to disclosures regarding legal and bankruptcy status when the counterparty is a U.S. person.

191 One commenter suggested including EMIR article 11(1)(a) and EMIR RTS article 12(1) through (3). The Commission agrees that these provisions are necessary to a finding of comparability. See SIFMA Letter II at Appendix A. As discussed in part IV.B.2 the Commission believes that EMIR RTS article 12(4) is relevant to its holistic, outcomes-oriented approach.

centrally cleared and subject to EMIR or cleared by a central counterparty that has been authorized or recognized to clear derivatives contracts by a relevant authority in the EU.[192] The Commission agrees with a commenter that the other proposed conditions to substituted compliance for trading relationship documentation should be retained.[193]

V. Substituted Compliance for Capital and Margin Requirements

A. Proposed approach

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

- Capital – Capital requirements pursuant to Exchange Act section 15F(e) and Exchange Act rule 18a-1 and its appendices (collectively "Exchange Act rule 18a-1") applicable to certain SBS Entities.[194] 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. 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

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192 See paras. (a)(5) and (a)(6) of the Order; see also part III.B, supra. Commenters supported those additions. See FBF Letter II at 2 (stating that "[t]he FBF is generally welcoming of the new general EMIR conditions that are introduced as a corollary to the above changes. As applied in the context of trading relationship documentation, trade acknowledgment and verification, they largely convey the manner in which EMIR has been interpreted."). See also SIFMA Letter II at 6 (stating that "we agree with the Commission that the cited provisions of EMIR are comparable to the Exchange Act trade acknowledgment and verification and trading relationship documentation requirements.").

193 See Better Markets Letter at 1-2.

194 17 CFR 240.18a-1 through 18a-1d. 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* Exchange Act rule 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).

orderly manner.[195] 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.[196]

- Margin – Margin requirements pursuant to Exchange Act section 15F(e) and Exchange Act rule 18a-3 for non-prudentially regulated SBS Entities.[197] The margin requirements are designed to protect SBS Entities from the consequences of a counterparty's default.[198]

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.

In proposing to provide conditional substituted compliance in connection with this part of the French Authorities' Application, the Commission's preliminary view was that relevant French and EU requirements would produce regulatory outcomes that are comparable to those associated with the above capital and margin requirements, by subjecting Covered Entities to financial responsibility requirements that are appropriate to the risks associated with their security-based swap businesses.[199] Substituted compliance accordingly would be conditioned on

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195 See Capital and Margin Adopting Release, 84 FR at 43879. 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 French Substituted Compliance Notice and Proposed Order, 85 FR at 85726. See French Authorities' Application Annex 1 category 1 capital portion at 1–24.

196 See 17 CFR 240.15c3-4 and 18a-1(f).

197 17 CFR 240.18a-3.

198 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").

199 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85726.

Covered Entities being subject to the French and EU provisions that, in the aggregate, establish a framework that produces outcomes comparable to those associated with the capital and margin requirements under the Exchange Act.[200]

However, the Commission also sought comment on whether substituted compliance with respect to Exchange Act capital requirements should be subject to additional conditions.[201] In particular, the Commission sought comment on the following potential conditions:

- A condition that would require a Covered Entity to maintain a minimum amount of liquid assets, such as a minimum ratio of liquid assets to illiquid assets (e.g., a ratio of liquid assets to illiquid assets of 80% to 20%, 70% to 30%, 60% to 40%). With respect to such a ratio, the Commission also requested comment on whether liquid and illiquid assets should be defined using the concept of assets that are allowable or not allowable as capital under Exchange Act rule 18a-1.
- A condition that would require a Covered Entity to be subject to a specific liquidity requirement, such as a requirement to maintain a pool of highly liquid assets to cover cash outflows during a 30-day period of stress.
- A condition that a Covered Entity must maintain equity capital or Tier 1 capital at least equal to the minimum fixed-dollar capital requirements under Exchange Act rule 18a-1 (e.g., equity capital or Tier 1 capital of at least $20 million).

Additionally, in the Reopening Release, the Commission again sought comment on whether substituted compliance with respect to Exchange Act capital requirements should be subject to additional conditions.[202] The Commission explained that the capital standard of Exchange Act rule 18a-1 is a net liquid assets test. Under this standard, an SBS Entity will have more than a dollar of highly liquid assets for each dollar of unsubordinated liabilities. Covered

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200 Id. at 85726 n.49.

201 Id. at 85736-37.

202 See Reopening Release, 86 FR at 18343-47.

Entities, however, are subject to capital requirements applicable to prudentially regulated entities based on the international capital standard for banks (the "Basel capital standard").[203] 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, and initial margin posted to counterparties). 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. For this reason, the Commission sought comment on the following potential conditions to applying substituted compliance to Exchange Act rule 18a-1:

- A condition that would require a Covered Entity to maintain an amount of assets that are allowable under Exchange Act rule 18a-1, after applying applicable haircuts under the Basel capital standard, that equals or exceeds the Covered Entity's current liabilities coming due in the next 365 days.
- A condition that would require a Covered Entity to make a quarterly record listing: (1) the assets maintained pursuant to the above condition, their value, and the amount of their applicable haircuts; and (2) the aggregate amount of the liabilities coming due in the next 365 days.
- A condition that would require a Covered Entity to maintains at least $100 million of equity capital composed of highly liquid assets, as defined in the Basel capital standard.
- A condition that would require a Covered Entity to include its most recent statement of financial condition (*i.e.*, balance sheet) filed with its local supervisor whether audited or unaudited with its written notice to the Commission of its intent to rely on substituted compliance.

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[203] See, e.g., Basel Committee on Banking Supervision ("BCBS"), The Basel Framework, available at: https://www.bis.org/basel_framework/.

B. Commenter views and final provisions

1. Capital

Consistent with the proposed Order, the first capital condition requires the covered entity to be subject to and comply with certain identified French and EU capital requirements.[204] As discussed at the end of this section, the Commission made some modifications to the French and EU laws and regulations cited in this condition.[205] For the reasons discussed below, there are two additional conditions to applying substituted compliance with respect to Exchange Act rule 18a-1.

For the reasons discussed above in part III.B.2.e of this release, the first additional capital condition is that the Covered Entity applies 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).[206] These recordkeeping and notification requirements are directly linked to the capital requirements of Exchange Act rule 18a-1. The UK Proposed Order conditioned 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.[207] This additional capital condition is designed to 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-1 pursuant this Order.

The second additional capital condition builds on and modifies the proposed capital condition that was the subject of the Commission's questions in the Reopening Release and that

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204 See para. (c)(1)(i) of the order. See also French Substituted Compliance Notice and Proposed Order, 85 FR at 85726.

205 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85726, n.49.

206 See para. (c)(1)(ii) of the Order.

207 See UK Substituted Compliance Notice and Proposed Order, 86 FR at 18395-403, 18416-17, 19419. The Commission sought comment in the Reopening Release on whether this approach should be taken in the final Order. See Reopening Release, 86 FR at 18348.

was designed to address potential different regulatory outcomes between Exchange Act rule 18a-1 and the French and EU capital requirements. In particular, the Commission asked questions about a four pronged condition with respect to applying substituted compliance to the capital requirements of Exchange Act rule 18a-1.[208] The first prong would require a Covered Entity to maintain an amount of assets that are allowable under Exchange Act rule 18a-1, after applying applicable haircuts under the Basel capital standard, that equals or exceeds the Covered Entity's current liabilities coming due in the next 365 days.[209] The second prong was linked to the first prong as it would require that a Covered Entity make a quarterly record listing: (1) the assets maintained pursuant to the first condition, their value, and the amount of their applicable haircuts; and (2) the aggregate amount of the liabilities coming due in the next 365 days. The third prong would require the Covered Entity to maintain at least $100 million of equity capital composed of highly liquid assets as defined in the Basel capital standard. The fourth prong 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.

One commenter recommended that the Commission consider denying substituted compliance for capital requirements on the basis that France's capital requirements do not produce comparable regulatory outcomes.[210] This commenter stated that "granting substituted compliance with multiple conditions intended to mimic the Commission's capital requirements would seem to undermine the entire point of substituted compliance in the first place; namely, protecting the stability of the U.S. financial system by allowing substituted compliance *only when* foreign regimes are comparable."[211]

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208 See id. at 18387-89 (discussing the additional conditions).

209 As used in this part V.B.1 of the release, the term "Covered Entity" refers to a security-based swap dealer located in the UK that does not have a prudential regulator.

210 Better Markets Letter at 7-8.

211 Better Markets Letter at 8 (emphasis in the original).

In describing the differences in the capital frameworks between the net liquid assets test and the Basel capital standard, this commenter highlighted the treatment of initial margin posted to a counterparty.[212] Specifically, the commenter stated that in France initial margin posted to a counterparty counts as capital for that entity, while in the U.S. initial margin only counts as capital if the security-based swap dealer has a special loan agreement with an affiliate. The commenter stated that the U.S. requirement is intended to mitigate counterparty credit risk with respect to the return of the initial margin. The commenter argued that the result is that, not only are the French requirements different from the Commission's in both form and substance, but the regulatory outcome is not comparable.

This commenter also stated that if a positive substituted compliance determination is made regarding capital, the Commission should not weaken the potential additional capital condition discussed in the Reopening Release in response to industry commenters, because these market participants are primarily concerned with reducing their own operational costs, without any regard to the systemic risk that would doing so would pose.[213] This commenter also stated that any determination to find Frances's capital requirements comparable to and as comprehensive as the Commission's capital framework without conditions at least as strong as proposed would not only contravene the Commission's own conception of substituted compliance "but expose the U.S. financial system to very risks Dodd-Frank instructed the SEC to contain."[214]

Another commenter supported the potential capital condition.[215] This commenter stated that the Commission should require Covered Entities to comply with the net liquid assets test

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212 Better Markets Letter at 7-8.

213 Better Markets Letter at 7-8.

214 Better Markets Letter at 7-8.

215 AFREF Letter at 1.

under Exchange Act rule 18a-1, rather than the Basel capital standards.[216] The commenter stated that the net liquid assets test "appropriately limits uncollateralized lending, fixed assets, and other illiquid assets such as real estate which have been proven repeatedly to be unreliable forms of capital but are currently counted" as allowable capital under the Basel capital standard.[217] This commenter also agreed with the Commission that "the initial margin that is posted is not available for other purposes and therefore, under the Basel standard, could swiftly result in less balance sheet liquidity than the standards under the Exchange Act's Rule 18a-1."[218]

A commenter supported the Commission's proposed Order to grant substituted compliance in connection with the Exchange Act capital requirements.[219] This commenter, however, opposed additional capital conditions.[220] The commenter reiterated this opposition with respect to the potential four pronged capital condition for which the Commission sought comment in the Reopening Release.[221] The commenter stated that the potential capital condition was unnecessary, unduly rushed, and highly likely to be costly and disruptive to market participants and inconsistent with the Commission's substituted compliance framework.[222] More specifically, this commenter stated that the potential capital conditions was unnecessary because

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216 See id. ("We support the Commission's proposal to require foreign security-based swap dealers and participants ("Covered Entities") to abide by capital and initial margin requirements that reflect Exchange Act rule 18a-1 standards appropriate for broker-dealers, as opposed to Basel capital requirements for banks that permit illiquid assets to count toward capital minimums.").

217 Id.

218 Id. at 2.

219 SIFMA Letter I at 10. See also FBF Letter I at 4; EBF Letter I at 1 (generally supporting SIFMA Letter I).

220 SIFMA Letter I at 11-13. See also FBF Letter I at 4.

221 SIFMA Letter II at 7-17. See also EBF Letter II at 1 ("The EBF further shares SIFMA's serious concerns that the potential conditions to substituted compliance with capital requirements described in the Release would create brand new, far-ranging capital and liquidity requirements that could not be established prior to the compliance date.") and FBF II Letter at 3-4 ("Last but certainly not least, the FBF shares SIFMA's serious concerns that the potential conditions to substituted compliance with capital requirements described in the Release would result in brand new, far-ranging capital and liquidity requirements that could not be established in time for registration, and would essentially force an exit of the relevant entity category from the U.S. SBS market prior to the de minimis counting date.")

222 SIFMA Letter II at 7-17.

Covered Entities transact predominantly in securities and derivatives, do not extensively engage in unsecured lending or other activities more typical of banks, and are already subject to extensive liquidity requirements.[223] The commenter also expressed concern that the potential capital condition was inconsistent with the Commission's substituted compliance framework in that it was duplicative of and would contradict the liquidity requirements established by French and EU authorities.[224] This commenter stated that the imposition of the potential capital condition would effectively substitute the Commission's judgment for that of the French and EU authorities in terms of the best way to address liquidity risk, and may lead other regulators to refuse to extend deference to the Commission's regulatory determinations.[225]

With respect to the using the concept of "allowable" and "nonallowable" assets under Exchange Act rule 18a-1, the commenter stated that the first and second prongs of the potential capital condition do not define these terms and there is no analogous concept in the capital framework applicable in France.[226] The commenter stated this would require firms to re-categorize every asset on their balance sheets, which would not be feasible in the near term.[227] Further, this commented asked the Commission to clarify what it means by "haircuts" with respect to the first and second prongs, since the Basel capital standard does not apply "haircuts" to assets, but instead applies a risk-weighted approach.[228]

This commenter also stated that the third prong of the potential additional capital condition requiring "at least $100 million of equity capital composed of 'highly liquid assets' as defined in the Basel capital standard," includes concepts that require clarification.[229] For

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223 SIFMA Letter II at 8.

224 SIFMA Letter II at 12-14.

225 SIFMA Letter II at 13.

226 SIFMA Letter II at 14.

227 SIFMA Letter II at 14.

228 SIFMA Letter II at 14.

229 SIFMA Letter II at 15.

example, this commenter stated that is unclear how a firm would calculate the amount of its "equity capital" that is "composed of highly liquid assets," since "equity" generally refers to a firm's paid-in capital, retained earnings and other items on the liabilities/shareholders' equity side of the balance sheet.[230] Finally, this commenter asserted that because it is approximately three months until the August 6th counting date, and firms may encounter significant operational challenges to meet the potential or revised capital condition, the potential condition may cause firms to exit the U.S. security-based swap market, or hope that the conditions are modified and delayed in a manner that will make it feasible to satisfy them.[231]

Overall, this commenter stated that the Commission should take a more incremental and deliberative approach to additional capital conditions, and specifically recommended that the Commission: (1) delete the first prong of the capital condition; (2) replace the second prong with a requirement that a nonbank Covered Entity provide the same reports concerning liquidity metrics that the Covered Entity provides to the French and EU authorities; (3) modify the third prong to require a nonbank Covered Entity to maintain at least $100 million of high quality liquid assets, as defined in the Basel capital standard; and (4) issue an order on October 6, 2024, determining whether to maintain, delete, modify or supplement the condition, based on consideration of the liquidity of nonbank Covered Entities, and after publishing a notice of any such changes for at least 90 days of public comment.[232]

The Commission agrees with the commenters who point out the differences between the capital standard of Exchange Act rule 18a-1 (i.e., the net liquid assets test) and the Basel capital standard applicable to Covered Entities, and who therefore believe that – at a minimum – additional capital conditions are necessary to achieve comparable regulatory outcomes.[233] As the

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230 SIFMA Letter II at 15.

231 SIFMA Letter II at 15-16.

232 SIFMA Letter II at 16-17.

233 See AFREF Letter at 1-2; Better Markets Letter at 7-8.

Commission explained when seeking comment on the potential additional capital condition, the net liquid assets test is designed to promote liquidity.[234] 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).[235] For example, Exchange Act rule 18a-1 allows securities positions to count as 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 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.

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234 See Reopening Release, 86 FR at 18343-45 (explaining the differences between Exchange Act rule 18a-1 and the Basel capital standard).

235 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 (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).

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 U.S. 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.[236] The amount remaining after these deductions is defined as "tentative net capital." Exchange Act rule 18a-1 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.[237] 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, Covered Entities in France are subject to the Basel capital standard. 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).

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236 See 17 CFR 240.15c3-1(c)(2).

237 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 under the Basel capital standards, available at: https://www.bis.org/basel_framework/chapter/LCR/30.htm?tldate=20191231&inforce=2019121. Generally, cash and securities that qualify as HQLA under the LCR would be allowable assets under Exchange Act rule 18a-1.

The Basel capital standard accommodates the business of banking: making loans (including extending unsecured credit) and taking deposits. While the Covered Entities that will 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 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 French margin requirements, Covered Entities will be required to post initial margin to counterparties unless an exception applies.[238] 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.[239] 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."[240] 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.

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

239 See Capital and Margin Adopting Release, 84 FR at 43887-88.

240 See id. at 43887.

For these reasons, the Commission disagrees with the commenter who stated that additional capital conditions were unnecessary and inconsistent with the Commission's substituted compliance framework.[241] As discussed above, 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 terms of the types of assets that count as regulatory capital and how regulatory capital is calculated lead to different regulatory outcomes.[242] 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.[243] The Basel capital standard – while having measures designed to promote liquidity – does not produce this regulatory outcome.[244] Therefore, an additional 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 French and EU laws and measures designed to promote liquidity. As a commenter stated, 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");[245] (2) requirements to hold a diversity of stable funding instruments sufficient to meet long-term obligations under both

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241 SIFMA Letter II at 7-17.

242 See Better Markets Letter at 7-8 (comparing the differences between Exchange Act rule 18a-1 and the Basel capital standard and stating that "not only are the France's capital requirements different from the SEC's in both form and substance, but the regulatory outcome is not comparable").

243 As discussed above, highly liquid assets under Exchange Act rule 18a-1 are also known as "allowable assets" and generally are consistent the LCR's HQLA.

244 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 will accommodate a firm that seeks to maintain this level of liquidity on its own accord.

245 See CRR, Article 412(1), Regulation (EU) 2015/61.

normal and stressed conditions (the "NSFR requirements");[246] (3) requirements to perform liquidity stress tests and manage liquidity risk (the "internal liquidity assessment requirements");[247] and (4) regular reviews of a Covered Entity's liquidity risk management processes by the French Authorities (the "French Authority liquidity review process").[248] These French and EU 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, an additional condition is necessary to supplement these requirements.

The Commission has taken into account the French and EU 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 the French Authorities' 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.[249] However, 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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246 See CRR, Article 413 and Articles 428a to 428az introduced by Regulation (EU) 2019/876 ("CRR II"), Article 1(116).

247 See CRD, Article 86, MFC Articles L. 511-41-1 B for credit institutions and L. 533-2-2 for investment firms; and Articles 148 to 186 of the Decree of 3 November 2014 on internal control.

248 See SIFMA Letter II at 9-12.

249 See Better Markets Letter at 8 (recommending that the Commission consider denying substituted compliance with respect to these Exchange Act capital requirements).

For these reasons, the Order includes an additional capital condition that will impose a simplified net liquid assets test.[250] This simplified test will 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 French and EU capital requirements,[251] LCR requirements, NSFR requirements, internal liquidity assessment requirements, and French Authority 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).

In response to comments, the Commission has modified the first three prongs of the additional capital condition, as discussed below.[252] In particular, the first and third prongs are being combined into a single prong of the second additional capital condition.[253] Under this prong, the Covered Entity must maintain liquid assets (as defined in the 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 (specified in the capital condition); and

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250 See AFREF Letter at 1 ("The Commission should require that SBS entities who want to operate in the U.S. comply with the Net Liquid Assets test under the Exchange Act rule 18a-1 rather than the Basel capital standards").

251 See, e.g., CRR, Part 1 (Own Funds, including Tier 1 capital) and Part 2 (Capital Requirements).

252 See AFREF Letter at 1 ("The Commission should require that SBS entities who want to operate in the U.S. comply with the Net Liquid Assets test under the Exchange Act rule 18a-1 rather than the Basel capital standards"); SIFMA Letter at 17 (raising concerns that the use of the concept of "allowable" assets under Exchange Act rule 18a-1 in the first condition would require Covered Entities to re-categorize every asset on their balance sheets, which also pertains to the second condition, and seeking clarification on to how to calculate "equity capital" and allocate it to highly liquid assets equal to or greater than $100 million).

253 The first prong of the proposed capital condition would have required a Covered Entity to maintain an amount of assets that are allowable under Exchange Act rule 18a-1, after applying applicable haircuts under the Basel capital standard, that equals or exceeds the Covered Entity's current liabilities coming due in the next 365 days. The second prong would have required the Covered Entity to make a quarterly record related to the first prong. The third prong would have required the Covered Entity to maintain at least $100 million of equity capital composed of highly liquid assets as defined in the Basel capital standard. See Reopening Release, 86 FR at 18345.

(2) $20 million after applying the deduction.[254] Thus, the condition increases the scope of the liquid assets requirement so that it must cover all liabilities (rather than those maturing in 365 days as was contemplated by the Commission's questions in the Reopening Release).

These modifications align the first prong more closely to 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 will require the Covered Entity to subtract total liabilities from total liquid assets. The amount remaining will need to equal or exceed $100 million. The modifications also align the condition more closely to 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 tentative net capital and the fixed-dollar minimum requires that net capital must equal or exceed *$20 million*. The first prong will 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 will need to equal or exceed $20 million.

For the purposes of the first prong of the second additional capital condition, "liquid assets" are 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).[255] 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-

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[254] See para. (c)(1)(iii)(A)(*1*) of the Order. The definition of "liquid assets" and the method of calculating the deductions are discussed below.

[255] See para. (c)(1)(iii)(B) of the Order.

1.[256] Further, the first four categories of liquid assets also are designed to align with how Covered Entities categorize liquid assets on their financial statements.[257] In addition, the commenter who has raised concerns about the potential capital conditions made similar comments with respect to proposed capital conditions that would apply to SBS Entities in the United Kingdom.[258] The commenter's letter to the Commission included a table summarizing categories of liquid assets on the balance sheets of six UK dealers (the "Balance Sheet Table") that the commenter expects will register with the Commission as security-based swap dealers, and that do not have a prudential regulator and therefore would be subject to Exchange Act rule 18a-1.[259]

The first category of liquid assets is cash and cash equivalents.[260] These assets 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.[261] The second category of liquid assets is

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256 See notes 237 and 243, supra (describing allowable assets under Exchange Act rule 18a-1).

257 As part of the application process, the French Authorities have stated that the only nonbank (i.e., non-prudentially regulated) French dealers that will register with the Commission as security-based swap dealers are French investment firms will be re-authorized by the European Central Bank as credit institutions in 2021. See French Authorities' Application (Side Letter for Capital Requirements). These large investment firms publish annual audited financial statements. See e.g., BofA Securities Europe SA 2020 Annual Report, available at: https://investor.bankofamerica.com/regulatory-and-other-filings/subsidiary-and-country-disclosures.

258 See Letter from Kyle L. Brandon, Managing Director, Head of Derivatives Policy, SIFMA (May 3, 2021) ("SIFMA UK Letter") at 9-20. This comment letter may be found on the Commission's website at: https://www.sec.gov/comments/s7-04-21/s70421.htm.

259 The categories of liquid assets identified in the Balance Sheet Table are: (1) "Cash/Cash Equivalents; (2) "Collateralised Agreements;" (3) "Trade/Other Receivables; cash collateral pledged;" and (4) "Trading/Financial Assets." See SIFMA UK Letter, Appendix C.

260 See para. (c)(1)(iii)(B)(*1*) of the Order.

261 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).

collateralized agreements.[262] These assets consist of secured financings where securities serve as collateral such as repurchase agreements and securities loaned transactions.[263] The third category of liquid assets is customer and other trading related receivables.[264] These assets consist of customer margin loans, receivables from broker-dealers, receivables related to fails to deliver, and receivables from clearing organizations.[265] The fourth category of liquid assets is trading and financial assets.[266] These assets consist of cash market securities positions and listed and over-the-counter derivatives positions.[267]

As discussed above, initial margin posted to a counterparty is treated differently under Exchange Act rule 18a-1 and the Basel capital standard, and commenters highlighted this difference.[268] The fifth category of liquid assets is 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 re-payment of the loan until the initial margin is returned to the Covered Entity; and (3) the liability of the Covered Entity to the lender can be fully satisfied by delivering the collateral serving as initial margin to the lender.[269] As discussed

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262 See para. (c)(1)(iii)(B)(*2*) of the Order.

263 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).

264 See para. (c)(1)(iii)(B)(*3*) of the Order.

265 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).

266 See para. (c)(1)(iii)(B)(*4*) of the Order.

267 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).

268 See Better Markets Letter at 7; AFREF Letter at 2. See also Reopening Release, 86 FR at 18344-45 (discussing the different treatment of initial margin posted to a counterparty).

269 See para. (c)(1)(iii)(B)(*5*) of the order.

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.[270] 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 the second additional capital condition, the Covered Entity must 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.[271]

If an asset does not fall within one of the five categories of "liquid assets" as defined in the Order,[272] it will be considered non-liquid, and could not be treated as a liquid asset for purposes of the second additional capital condition in the Order. For example, one commenter listed the following categories of non-liquid assets on the Balance Sheet Table: (1) "Investments;" (2) "Loans;" and (3) "Other Assets."[273] Assets that fall into these categories could not be treated as liquid 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 generally refers to assets that do not fall into any of the other categories of liquid or non-liquid assets. These non-liquid "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 the second additional capital condition will require the Covered Entity to subtract total liabilities from total liquid assets and then apply a deduction

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270 See Capital and Margin Adopting Release, 84 FR at 43887-88.

271 Id.

272 See para. (c)(1)(iii)(B) of the Order.

273 See SIFMA UK Letter, Appendix C.

(haircut) to the difference.[274] The amount remaining after the deduction will need to equal or exceed $20 million. The method of calculating the amount of the deduction relies on the calculations Covered Entities must make under the Basel capital standard.[275] In particular, under the Basel capital 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 asset 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, it is 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 second additional capital condition.

Under the Basel capital standard, Covered Entities must hold regulatory capital equal to at least 8% of the amount of their risk-weighted assets.[276] Therefore, the deduction (haircut) required for purposes of the first prong of the second additional capital condition is determined by dividing the amount of the Covered Entity's risk-weighted assets by 12.5 (i.e., the reciprocal of 8%).[277] In sum, the Covered Entity must maintain an excess of liquid assets over total

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274 See para. (c)(1)(ii)(A)(*1*) of the order.

275 See BCBS, Risk-based capital requirements (RBC20), available at: https://www.bis.org/basel_framework/chapter/RBC/20.htm?inforce=20191215&published=20191215.

276 Id.

277 See para. (c)(1)(iii)(C) of the 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 will make up the substantial majority of the risk-weighted assets. In addition, the

liabilities that equals or exceeds $100 million before the deduction (derived from the firm's risk-weighted assets) and $20 million after the deduction.[278]

The second prong of the second additional capital condition requires 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 amount of the difference between the two amounts ("the excess liquid assets amount"); and (3) shows the amount of the deduction required under the first prong and the amount that deduction reduces the excess liquid assets amount.[279] This prong has been modified from the proposed Order to conform to the modifications to the first and third prongs of the proposed capital condition discussed above (i.e., combining them into a single prong that imposes a simplified net liquid assets test). Under the Order, the quarterly record will include details showing whether the Covered Entity is meeting the $100 million and $20 million requirements of the first prong.

The third prong of the second additional capital condition requires 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

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Commission believes that this method of calculating the deduction in the first prong of the second 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).

[278] 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 the second additional 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 the second additional capital condition.

[279] See para. (c)(1)(iii)(A)(*2*) of the order.

notice the contact information of an individual who can provide further information about the failure to meet the requirements.[280] As discussed above, the first additional capital condition requires the Covered Entity to apply substituted compliance with respect to notification requirements of Exchange Act rule 18a-8 relating to capital.[281] A Covered Entity applying substituted compliance with respect to Exchange Act rule 18a-8 must simultaneously submit to the Commission any notifications relating to capital that it must submit to the French authorities. However, French and EU notification requirements do not address a failure to adhere to the simplified net liquid assets test required by the first prong of the second additional 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 requires the Covered Entity to notify the Commission if the firm fails to meet the requirements of the first prong. This will 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 the additional capital condition in the proposed Order would have required 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. No commenters raised specific concerns with this condition and the Order includes it as proposed, but now it is the fourth prong of the *second* additional capital condition.[282]

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280 See para. (c)(1)(iii)(A)(*3*) of the Order.

281 See para. (c)(1)(ii) of the Order.

282 See para. (c)(1)(iii)(A)(*4*) of the Order. As discussed above, a commenter objected to the capital conditions generally and provided specific comments with respect to the first three conditions, but not the fourth condition. See SIFMA Letter at 9-20. This commenter did support the fourth condition as part of its recommended incremental approach to implementing the capital conditions. See SIFMA Letter at 19-20.

The commenter who opposed additional capital conditions stated that their burdens would be disruptive to market participants and could cause Covered Entities to exit the U.S. security-based swap market.[283] However, this may not be case. For example, the commenter stated that the Covered Entities expected to register with the Commission transact predominantly in securities and derivatives and do not extensively engage in unsecured lending or other activities more typical of banks.[284] The commenter based this statement on a high-level review of public information about the balance sheets of six Covered Entities undertaken to create the Balance Sheet Table.[285] Based on this review, the commenter stated that the "vast majority of each firm's total assets consists of cash and cash equivalents, collateralized agreements, trade and other receivables, and other trading and financial assets. The commenter characterized these assets as being "liquid." The commenter stated further that the amount of illiquid assets held by these firms as a proportion of their balance sheets is comparable to the proportion of illiquid assets held by U.S. broker-dealers. The commenter also stated that the long-term debt, subordinated debt, and equity of the Covered Entities, as a proportion of their total liabilities and equity, also was comparable to U.S. broker-dealers. Moreover, based on the Balance Sheet Table and the staff's analysis of the public financial reports of the major investment firms regulated by the Prudential Regulatory Authority ("PRA") in the United Kingdom (i.e. a PRA-designated investment firm) and a large investment firm in France, these firms report total liquid assets that exceed total liabilities and, in most cases, substantially in excess of $100 million.[286]

This information suggests that Covered Entities may be able to meet the second additional capital condition without having to significantly adjust their assets, liabilities, and

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283 See SIFMA Letter at 19.

284 See SIFMA Letter at 10-11.

285 See SIFMA Letter at 10-11, Appendix C.

286 The Bank of England publishes a list of PRA-designated investment firms. This list is available at: https://www.bankofengland.co.uk/prudential-regulation/authorisations/which-firms-does-the-pra-regulate

equity. Moreover, the modifications to the second additional capital condition that incorporate how Covered Entities categorize liquid and illiquid assets and calculate risk-weighted assets, will allow them to use existing processes to derive the measures needed to adhere to the condition. Therefore, while the condition imposes a simplified net liquid assets test and associated recordkeeping requirement, it may not cause Covered Entities to withdraw from the U.S. security-based swap market. Nonetheless, it is possible that the simplified net liquid assets test and associated recordkeeping burden could cause a Covered Entity to withdraw from the U.S. security-based swap market. However, as discussed above, this additional capital condition is designed to produce a comparable regulatory outcome with respect to SBS Entities subject to Exchange Act rule 18a-1 and Covered Entities applying substituted compliance with respect to that rule.

In response to a specific request for comment in the Reopening Release, a commenter stated that the capital conditions would not be necessary if the balance sheets of the Covered Entities seeking to apply substituted compliance with respect to Exchange Act rule 18a-1 were similar to the balance sheets of U.S. broker-dealers.[287] However, the Commission also sought comment on whether the capital conditions would serve to ensure that these firms do not engage in non-securities business activities that could impair their liquidity.[288] Two commenters expressed support for the capital conditions.[289] The fact that today certain Covered Entities have liquid balance sheets does not mean this will hold true in the future or with respect to other potential registrants. For these reasons, it is appropriate to include additional conditions with respect to applying substituted compliance to Exchange Act rule 18a-1.

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[287] See SIFMA Letter II at 8; Reopening Release, 86 FR at 18345.

[288] Reopening Release, 86 FR at 18345.

[289] See Better Markets Letter at 7-8; AFREF Letter at 1-2.

It would not be appropriate to take a more incremental approach to the additional capital conditions as suggested by a commenter.[290] Substituted compliance is premised on comparable regulatory outcomes. As discussed above, the additional capital condition is designed to supplement French and EU capital laws in order to achieve a comparable regulatory outcome in terms of the net liquid assets test of Exchange Act rule 18a-1. Delaying the implementation of the additional capital condition would mean that Covered Entities are operating as registered security-based swap dealers under a capital standard that does impose the net liquid assets test. This would be inconsistent with the objective of substituted compliance and could increase risk to the U.S. security-based swap markets and participants in those markets. Moreover, the modifications to the capital conditions discussed above may ease the implementation burdens.

In addition, the Commission does not believe a commenter's suggestion for an alternative capital condition requiring a Covered Entity to maintain $100 million of HQLA as defined in the LCR requirements would be adequate in terms of achieving comparable regulatory outcomes with Exchange Act rule 18a-1.[291] The Balance Sheet Table and public financial reports of investment firms in the UK and France indicates that Covered Entities have total liabilities of many billions of dollars.[292] A condition requiring $100 million in highly liquid assets would not cover these liabilities and would not impose a net liquid assets test.

Finally, the Commission has modified the citations to French and EU laws in the capital section of the Order in response to comment and further analysis.[293] In response to comments, the capital section of the Order does not cite "recitals" because they are not part of a legally binding regulation.[294]

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290 See SIFMA Letter II at 16-17.

291 See SIFMA Letter II at 16.

292 See SIFMA UK Letter, Appendix C.

293 SIFMA Letter II at Appendix A.

294 SIFMA Letter II, Appendix A.

The Commission agrees with the comments that the specific provisions to the CRR citied in the proposed Order are not comprehensive .[295] In response, the Commission has modified the final ordering language to use more comprehensive citations to the CRR (including the specific CRR provisions cited in the proposed Order), as the capital analysis includes only discussion of entities that are fully subject to CRR and CRD IV.[296] In addition, this commenter recommended that the Commission modify the final ordering language to qualify the citations to the CRR with a reference to waivers and permissions.[297] In response, the specific provisions in the CRR referenced in the capital comparability analysis were analysed without reference to waivers or permissions, and the condition states that the Covered Entity must be subject to and comply with these specific capital requirements. Therefore, the more comprehensive references to the CRR in the final order are cited without reference to waivers or permissions.

Further, the Commission agrees with the commenter that some of the citations do not relate to requirements imposed on Covered Entities, but generally relate to the powers of relevant authorities. In these cases, citations in the ordering language have been deleted or modified to reference requirements that a Covered Entity is subject to and must comply with.[298]

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295 SIFMA Letter II, Appendix A.

296 French Authorities' Application (Side Letter for Capital Requirements) at p.4. More specifically, in the final Order, the Commission is including references to the CRR to read: 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).

297 SIFMA Letter II, Appendix A.

298 More specifically, in the final order, the Commission is: (1) deleting BRRD Articles 27(1), 31(2), 31(1)(a) and (5), and 32(5); (2) deleting CRD Articles 97, 98(1)(e), 98(6), 99, 100(1), 102(1), 104, 104(1), 105. 142(4) and narrowing the scope of Article 142 to (1) and (2); (3) deleting MFC Articles L. 511-15; 511-41-1 A(XIV), L. 511-41-3.II-IV., L. 511-41-1 C, L. 511-41-3, L. 511-41-4, L. 511-41-5, L. 511-42, L. 532-6, L. 533-2-3, L. 612-24, R. 612-30, L. 612-32, R. 612-32, L. 612-33.I, L. 612-33.II, L. 612-40, and L. 613-50.I, L. 631-2-1, narrowing the reference to L. 613-49 to 613-49I.; (4) deleting the reference to Article 10 of the Decree of 3 November 2014 on internal control; (5) deleting the Ministerial Order on the Supervisory Review and Evaluation Process, articles 6 through 10; and (6) deleting Articles 37, 38, 63, and 64 of Decree of 3 November 2014 relating to capital buffers.

In response to the comment that the reference to MFC Article L. 511-13 be deleted because it relates to governance requirements and is beyond the scope of capital requirements, the Commission agrees. Therefore, the Commission is deleting this reference from the Order.

Further, in response to comments to insert the phrase "as applicable" in certain places in the capital condition, the Commission is not modifying the Order to ensure Covered Entities remain subject to and comply with the laws and regulations cited in the capital condition. The Commission acknowledges that some of the citations to the French laws apply only to specific types of institutions (i.e. credit institutions or investment firms).[299] In such cases, a Covered Entity would comply with the relevant citation in the MFC article that corresponds to its entity type.

In response to the comment that the Commission narrow the scope of references to CRD Articles 129 (Requirement to maintain a capital conservation buffer), 130 (Requirement to maintain an institution-specific countercyclical capital buffer), and 131 (Global and other systemically important institutions) because some of the paragraphs do not impose any obligations on firms, the Commission disagrees and is retaining these citations in the Order. These references were cited in the French Authorities' Application in their entirety with reference to the requirement that "institutions must maintain certain capital buffers above the minimum 8 percent capital level composed of Common Equity Tier 1 capital instruments."[300] Therefore, it is appropriate to retain these citations in the Order.

In response to the comments that the Commission update the reference to BRRD Article 45(6), since it had been amended, the Commission is retaining the reference, since the references are to citations in the French Authorities' Application.[301] In addition, the term BRRD means

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[299] For example, Article L. 511-41-1-B of the MFC implements Article 73 of CRD (Internal Capital) for credit institutions, and MFC article L. 533-2-2 implements it for investment firms.

[300] French Authorities' Application, Side Letter for Capital Requirements at n.13 (and accompanying text).

[301] See SIFMA Letter II at Appendix A.

Bank Recovery and Resolution Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014, as amended from time to time. Therefore, amendments to the BRRD are already included in the definition and covered by the capital conditions in the Order.[302]

In addition, in response to a recommendation to delete references to the EMIR margin requirements, the Commission is retaining the references to the EMIR Margin RTS requirements as the French Authorities' Application states "if liquidation did occur, EU regulations also protect counterparties and promote continued market liquidity through margin requirements."[303] Finally, the references to the EMIR Margin RTS and the final references in the capital ordering language contribute to the conclusion that French and EU laws produces a comparable regulatory outcome to the capital requirements under the Exchange Act.

2. Margin

The Commission's preliminary view, based on the French Authorities' Application and the Commission's review of applicable provisions, was that relevant French and EU margin requirements would produce regulatory outcomes that are comparable to those associated with Exchange Act margin requirements without the need for additional conditions.[304] For example, in adopting final margin requirements for non-cleared security-based swaps, the Commission modified the rule to more closely align it 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

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302 The commenter also recommended deleting CRD Article 23 since it has been replaced by recent amendments to CRD. The proposed Order does not cite Article 23 of the CRD. Therefore, this comment is moot.

303 French Authorities' Application, Side Letter for Capital Requirements at 22. For example, the EMIR Margin RTS require a Covered Entity to segregate initial margin from the firm's assets by either placing it with a third-party holder or custodian or via other legally binding arrangements, making the initial margin remote in the case of the firm's default or insolvency. Id.

304 French Substituted Compliance Notice and Proposed Order, 85 FR at 85726.

Securities Commissions ("IOSCO") with respect to margin requirements for non-centrally cleared derivatives.[305]

Exchange Act rule 18a-3 and the French and EU margin rules require firms to collect liquid collateral from a counterparty to cover variation and/or initial margin requirements.[306] 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.[307] 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.[308] 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.[309] Both sets of rules have 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.[310] Both sets of rules also permit a threshold below which initial margin is not required to be collected and incorporate a minimum transfer amount.[311]

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305 Id., 85 FR at 85726, n.50; 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 French and EU margin requirements also are based on the recommendation in the BCBS/IOSCO Paper.

306 See 17 CFR 240.18a-3(c)(1)(ii) and French Authorities' Application at 27-28.

307 See 17 CFR 240.18a-3(c)(1)(ii) and French Authorities' Application at 40-43.

308 See 17 CFR 240.18a-3(d)(2)(i) and French Authorities' Application at 12-20.

309 See 17 CFR 240.18a-3(d)(2)(i) and French Authorities' Application 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 under which initial margin models have to be approved (initial and ongoing approval). EU 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).

310 See 17 CFR 240.18a-3(c)(1)(iii) and French Authorities' Application at 54-65.

311 See 17 CFR 240.18a-3(c)(1)(iii) and French Authorities' Application at 54-65.

In the French Substituted Compliance Notice and Proposed Order, the Commission stated substituted compliance with respect to the margin requirements accordingly would be conditioned on Covered Entities being subject to those French and EU provisions that, the Commission has determined, in the aggregate, establish a framework that produces outcomes comparable to those associated with the requirements under the Exchange Act rule 18a-3.[312] Commenters supported the Commission's proposed approach for substituted compliance with respect to margin requirements.[313]

One commenter suggested technical comments with respect to refining the French and EU laws cited in the proposed Order.[314] In particular, this commenter recommended that the Commission (1) delete the citations to the CRR; (2) narrow the scope of the reference to EMIR Article 11 to Article 11(3); and (3) insert the phrase "as applicable" before the citations to the French laws.[315] The Commission disagrees with the commenter that the scope of the citation to EMIR Article 11 should be narrowed. Other provisions of EMIR Article 11 relate to margin requirements, including the provisions regarding intragroup transactions. Therefore, the Commission is not modifying this citation in the final order. With respect to the suggestion by the commenter to delete references to the CRR requirements, the Commission concludes that the requirements which were set out in the proposed Order, contribute to the conclusion that French and EU law produce a comparable regulatory outcome to the margin requirements under the Exchange Act.[316] Finally, the Commission is not modifying the Order to insert the phrase "as applicable" because it is overly broad. The Commission acknowledges that some of the citations

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312 French Substituted Compliance Notice and Proposed Order, 85 FR at 85726.

313 FBF Letter I at 4; SIFMA Letter I at 13.

314 SIFMA Letter II, Appendix A.

315 SIFMA Letter II, Appendix A.

316 The references to the CRR were included in the comparability assessment for margin requirements, and in the Commission's view the holistic approach for comparing regulatory outcomes should seek to reflect the whole of a jurisdiction's relevant requirements, rather than select subsets of those requirements.

to the French laws apply only to specific types of institutions (i.e. credit institutions or investment firms).[317] In such cases, a Covered Entity would comply with the relevant citation in the MFC article that corresponds to its entity type. For the foregoing reasons, the first margin condition requires the covered entity to be subject to and comply with certain identified French and EU margin requirements.[318]

The proposed Order did not contain any additional conditions for substituted compliance with respect to the margin requirements of Exchange Act section 15F(e) and Exchange Act rule 18a-3. The Commission, however, requested comment on whether there were any conditions that should be applied to substituted compliance for the margin requirements to promote comparable regulatory outcomes.[319] As discussed below, in response to comments received, the Order includes two additional margin conditions designed to produce comparable regulatory outcomes with respect to collecting variation and initial margin from counterparties.[320]

In particular, a commenter raised general concerns with the Commission's regulatory outcomes approach to substituted compliance, and suggested additional general principles that the Commission should consider in evaluating applications for substituted compliance.[321] This commenter believed regulatory arbitrage within and outside the United States was one of the key factors that led to and exacerbated the 2008 financial crisis, and stated that the Dodd-Frank Act was enacted in response, which includes the Commission's authority to promulgate capital,

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317 For example Article L. 511-41-1-B of the MFC implements Article 73 of CRD (Internal Capital) for credit institutions, and MFC article L. 533-2-2 implements it for investment firms.

318 See para. (c)(2)(i) of the order. The first margin condition requires that Covered Entities must be subject to and 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); MFC articles L. 511-41-1-B, L. 533-2-2, L. 533-29, I al. 1, and L. 511-55 al. 1; and Decree of 3 November 2014 on internal control, article 114.

319 French Substituted Compliance Notice and Proposed Order, 85 FR at 85737.

320 See paras. (c)(2)(ii) and (iii) of the order.

321 Better Markets Letter at 3.

margin, and other rules for non-cleared security-based swaps "to reduce the possibility and severity of another crisis related to excessive buildup of risk in the swaps markets."[322]

The Commission responds to the comments on the Commission's approach to substituted compliance in part II.D.2 above. However, as stated above, the commenter raises concerns about regulatory arbitrage and the potential impacts of differences in requirements that merit re-consideration of whether additional margin conditions are needed to produce comparable regulatory outcomes.[323] When proposing margin requirements for non-cleared security-based swaps, the Commission stated 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."[324] Further, the comparability criteria for margin requirements under Exchange Act rule 3a71-6 provides that prior to making a substituted 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.[325] 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.[326]

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322 Better Markets Letter at 2.

323 Better Markets Letter at 2-3.

324 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, 2021), 77 FR 70214, 70258 (Nov. 23, 2012).

325 See 17 CFR 240.3a71-6(d)(5)(i) and (ii).

326 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.

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.[327] Under the French and EU margin requirements, there are exceptions from the variation margin requirements for certain intragroup transactions (i.e., transactions between affiliates).[328] In addition, Exchange Act rule 18a-3 requires firms to collect initial margin from all counterparties, unless an exception applies.[329] 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. In contrast, the French and EU 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.[330]

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.[331] Consequently, it is appropriate to impose additional

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327 See 17 CFR 240.18a-3(c)(ii)(A)(*1*) and (*2*).

328 French Authorities' Application at 60.

329 See 17 CFR 240.18a-3(c)(ii)(B).

330 French Authorities' Application at 7. These thresholds are being phased-in with the last initial margin threshold set at EUR 8 billion.

331 The Commission recognizes there are also cases where the French and EU margin rules are more restrictive than Exchange Act rule 18a-3. French and 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, French and 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 French and EU margin rules are comparable to Exchange Act rule 18a-3.

margin conditions to produce comparable regulatory outcomes in terms of counterparty exceptions between Exchange Act rule 18a-3 and the French and EU requirements.

The first additional condition addresses differences in the counterparty exceptions with respect to variation margin. It requires 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 Covered Entity.[332] This condition defines 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 French and EU margin requirements, including calculation, collateral, documentation, and timing of collection requirements. The first additional condition will close the gap between the counterparty exceptions of Exchange Act rule 18a-3 and the French and EU margin rules with respect to variation margin.

The second additional condition addresses differences in the counterparty exceptions with respect to initial margin. It requires 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 Covered Entity.[333] The condition defines 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 French and EU margin requirements, including calculation, collateral, documentation, and timing of collection requirements. The second additional condition will close the gap between

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332 See para. (c)(2)(ii) of the order.

333 See para. (c)(2)(iii) of the order.

the counterparty exceptions of Exchange Act rule 18a-3 and the French and EU margin rules with respect to initial margin.

Finally, for the reasons discussed above in part III.B.2.e of this release, the third additional condition is that the Covered Entity applies substituted compliance with respect to Exchange Act rules 18a-5(a)(12) (a record making requirement).[334] This record making requirement is directly linked to the margin requirements of Exchange Act rule 18a-3. The UK Proposed Order conditioned substituted compliance with respect to this record making requirement on the Covered Entity applying substituted compliance with respect to Exchange Act rule 18a-3.[335] This additional 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 Order.

VI. Substituted Compliance for Internal Supervision and Compliance Requirements

A. Proposed approach

The French Authorities' Application further requested substituted compliance in connection with requirements relating to:

- Internal supervision – Diligent internal supervision and conflict of interest provisions that generally require SBS Entities to establish, maintain and enforce supervisory policies and procedures that reasonably are designed to prevent violations of applicable law, and implement certain systems and procedures related to conflicts of interest.
- Chief compliance officers – Chief compliance officer provisions that generally require SBS Entities to designate individuals with the responsibility and authority to establish, administer and review compliance policies and procedures, to resolve conflicts of interest, and to prepare and certify annual compliance reports to the Commission.

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334 See para. (c)(2)(iv) of the Order.

335 See UK Substituted Compliance Notice and Proposed Order, 86 FR at 18396-98, 18416. The Commission sought comment in the Reopening Release on whether this approach should be taken in the final Order. See Reopening Release, 86 FR at 18348.

- Additional Exchange Act section 15F(j) requirements – Certain additional requirements related to information-gathering and antitrust prohibitions.[336]

Taken as a whole, these requirements generally help to advance SBS Entities' use of structures, processes and responsible personnel reasonably designed to promote compliance with applicable law, identify and cure instances of noncompliance, and manage conflicts of interest.

In proposing to provide conditional substituted compliance in connection with this part of the French Authorities' Application, the Commission preliminarily concluded that the relevant French and EU requirements in general would produce comparable regulatory outcomes by providing that French SBS Entities have structures and processes that reasonably are designed to promote compliance with applicable law and to identify and cure instances of non-compliance and manage conflicts of interest. Substituted compliance under the proposed Order was to be conditioned in part on SBS Entities being subject to and complying with specified French and EU provisions that in the aggregate produce regulatory outcomes that are comparable to those associated with those internal supervision, compliance and related requirements under the Exchange Act.[337]

Under the proposed Order, substituted compliance was to be subject to certain additional conditions to help ensure the comparability of regulatory outcomes. First, substituted compliance in connection with the internal supervision requirements would be conditioned on the Covered Entities complying with applicable French and EU supervisory and compliance provisions as if those provisions also require the Covered Entities to comply with applicable requirements under the Exchange Act and the other conditions of the Order. This condition was intended to reflect that, even with substituted compliance, Covered Entities still directly would

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336 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85726-27.

337 See id. at 85727 n.55.

be subject to a number of requirements under the Exchange Act and conditions of the Order that fall outside the ambit of French and EU internal supervision and compliance requirements.[338]

For similar reasons, the proposed Order conditioned substituted compliance in connection with compliance report requirements on the Covered Entity annually providing the Commission with certain compliance reports required pursuant to regulations under MiFID Org Reg 22(2)(C). Those reports must be in English, be accompanied by a certification under penalty of law that the report is accurate and complete, and would have to address the SBS Entity's compliance with other conditions to the substituted compliance order.[339] In addition, substituted compliance under the proposal would not extend to antitrust provisions under the Exchange Act, based on the preliminary conclusion that allowing an alternative means of compliance would not lead to comparable regulatory outcomes.[340]

B. Commenter views and final provisions

Following the release of the proposed Order, commenters requested that the conditions to substituted compliance in connection with the internal supervision and compliance requirements be narrowed by eliminating references to recordkeeping requirements pursuant to MiFID, and CRD provisions related to the treatment of risk. In the commenter's view, compliance with those provisions are not necessary to justify substituted compliance.[341]

Partially in response to the initial comments to the proposed Order, the Reopening Release requested comment on a revision to the Order to include two additional prerequisites in connection with internal supervision: CRR articles 286 through 288 and 293, which address counterparty credit risk and risk management generally; and EMIR Margin RTS article 2, which

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338 See id. at 85727-85728. The condition was designed to allow Covered Entities to use their existing internal supervision and compliance frameworks to comply with the relevant Exchange Act requirements and Order conditions, rather than having to establish separate special-purpose supervision and compliance frameworks.

339 See id. at 85728.

340 See id.

341 See SIFMA Letter at 6-7.

addresses collateral-related risk management procedures.[342] The proposed additions were intended to promote analogous compliance goals as the other requirements identified within paragraph (d)(3) of the proposed Order.[343] The only commenter to address the proposed additions did not support them.[344]

Commenters requested additional alterations to the internal supervision conditions aside from those identified in the Reopening Release. Specifically, commenters recommended changes to the compliance report certification language described in paragraph (d)(2)(ii)(B) of the proposed Order, that "under penalty of law, the report is accurate and complete," to language "consistent with the requirement of the linked Exchange Act rule, Exchange Act rule 15Fk-1(c)(2)(ii)(D)."[345] Additionally, one commenter requested that the condition requiring Covered Entities to provide certain reports pursuant to MiFID Org Reg Article 22(2)(c) should "apply solely to the extent [the reports] are related to a Covered Entity's business as an SBS Entity."[346] Commenters also requested that the timing of compliance report submissions for reports required under MiFID Org Reg Article 22(2)(c) be "15 days after the Covered Entity completes its annual MiFID report as required by MiFID"[347] and alternatively "15 days after [the report's] submission to the AMF in April each year."[348]

The Commission has considered commenter's views, and is making changes to the final Order related to compliance report certification, the timing of submission of compliance reports

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342 See Reopening Release, 86 FR at 18384.

343 See id.

344 See SIFMA Letter II at 18-19 (stating that "[g]iven that paragraph (d) of the French Order does not extend to the risk management requirements of Exchange Act Section 15F(j)(2) or related requirements of Exchange Act rule 15Fh-3(h), which the French Order instead addresses separately in paragraph (b)(1), we fail to see the justification for adding these requirements to paragraph (d)(3)").

345 Id. at 19. See also, FBF Letter II at 3 (stating that "the attestation language a bank would need to use when furnishing home country reports is stricter than that required under the SEC rule itself.")

346 SIFMA Letter II at 19.

347 Id. at 19-20.

348 FBF Letter II at 3.

to the Commission, and certain French and EU predicates to substituted compliance. In large part, however, the Commission is adopting this part of the Order as it was proposed.

1. French and EU predicate conditions to Internal Supervision and Compliance Requirements

In the French Substituted Compliance Notice and Proposed Order, the Commission preliminarily proposed to make a positive substituted compliance determination for supervisory and compliance requirements conditioned on Covered Entities complying with specified French and EU requirements that promote internal supervision within those entities.[349] A commenter requested that the Commission not require a Covered Entity to be subject to and comply with certain of these specified requirements because the commenter argued the provisions were related to risk management and therefore should be deleted or addressed elsewhere or alternatively the provisions do not correspond to, and go beyond, the requirements of the Exchange Act.[350] The Commission details below its consideration of these comments.

One commenter objected to the proposed inclusion of the risk control requirements of CRD articles 79 through 87, and French implementing provisions, Internal Control Order articles 111, 121 and 130 through 134, within the prerequisites to substituted compliance for internal supervision and control, on the grounds that the inclusion of those provisions "are not necessary" to justify substituted compliance.[351] The commenter also recommended deleting the reference to MiFID Org Reg article 23 related to risk management and which the commenter believed was more appropriately addressed with the risk control requirements found in paragraph (b) of the

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349 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85740.

350 See SIFMA Letter II at Appendix A. Specifically, SIFMA recommends the deletion of the following conditions from paragraph (d)(3) of the proposed Order: (i) MiFID articles 16(6) through (10); (ii) MiFID Org Reg articles 23, 27, 30 through 32, 72 through 76 and Annex IV; (iii) CRD articles 79 through 87 and 92 through 95; (iv) MFC articles L. 511-71 through 86, L. 511-89 through 97 and L. 511-102; (v) French Internal Control Order articles 111, 121 and 130 through 134; (vi) MFC article R. 511-16-3; and (vii) Prudential Supervision and Risk Assessment Order article 7.

351 SIFMA Letter I at 6-7.

proposed Order.[352] Following the comment period reopening, that commenter further objected to the Commission's suggested inclusion of CRR articles 286-88 and 293 (addressing counterparty credit risk and risk management generally) and EMIR Margin RTS article 2 (addressing collateral-related risk management procedures) to the prerequisites.[353] The commenter argued that those additions inappropriately would "expand the substantive ambit of the linked Exchange Act requirements."[354] The Commission nonetheless concludes that those CRD, CRR, MiFID Org Reg, and EMIR Margin RTS provisions appropriately constitute part of the substituted compliance conditions for internal supervision and compliance. Supervision and compliance requirements serve the purpose of causing registered entities to have systems and follow practices to help ensure they conduct their business as required. It would be paradoxical to conclude that an SBS Entity that fails to implement requisite internal risk management systems and practices nonetheless may be considered to be following supervision and compliance standards that are sufficient to meet the regulatory outcomes required under the Exchange Act. A risk management failure necessarily constitutes a compliance failure. Accordingly, the Commission is retaining the references to these provisions. The commenter also requested the removal of MFC R. 511-16-3, based on the claim that it does not exist.[355] However, the Commission has not determined that to be the case.[356]

One commenter recommended that the Commission delete MiFID article 16(6) through 16(10) related to recordkeeping and client asset safeguarding requirements and the

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352 See id. at Appendix A.

353 See Reopening Release, 86 FR at 18348 (stating that those provisions "promote analogous compliance goals" as the other proposed conditions to substituted compliance for internal supervision and compliance).

354 SIFMA Letter II at 18-19 ("Simply asserting that these requirements 'promote analogous compliance goals' is not enough; under that theory, seemingly every provision of EU or French law would be relevant to internal supervision and compliance, but this cannot be the case.").

355 SIFMA Letter II at Appendix A.

356 MFC R. 511-16-3 acts as the French implementing provision for CRD article 91(8), which the commenter did not object to including, and both of which were included in the proposed Order and are now included in paragraph (d)(3) of the Order.

corresponding French implementing provisions;[357] CRD articles 92 through 95, MFC articles L. 511.71 through L. 511.86, and MiFID Org Reg article 27 related to remuneration, MiFID Org Reg articles 30 through 32 related to outsourcing;[358] and MFC articles L. 511-89 through L. 511-97 and L. 511-102 related to risk and remuneration committees. The commenter stated that those provisions "do not correspond to, and go beyond," the applicable requirements of the Exchange Act.[359] In addition, the commenter stated that the MiFID provisions "did not relate to supervisory or compliance requirements."[360] The Commission believes that the MiFID and corresponding French implementing provisions and MiFID Org Reg conditions taken as a whole are relevant to its substituted compliance determination for internal supervision and compliance and taken together the specified French and EU provisions promote adequate supervision within the Covered Entities complying with those requirements. Accordingly, the Commission is retaining the references to these provisions with one exception.[361]

The comparability analysis requires consideration of Exchange Act requirements as a whole against analogous French and EU requirements as a whole, recognizing that U.S. and non-U.S. regimes may follow materially different approaches in terms of specificity and technical content. This "as a whole" approach – which the Commission is following in lieu of requiring requirement-by-requirement similarity – further means that the conditions to substituted compliance should encompass all French and EU requirements that establish comparability with

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357 MiFID articles 16(6) through 16(10) is implemented in France in MFC articles 1.533-10.II 6 through 9 and L. 533-10.III which are included as conditions to supervisory and compliance substituted compliance in paragraph (d)(3) of the Order.

358 See SIFMA Letter II at Appendix A. Paragraph (d)(3) of the proposed Order also included MiFID Org Reg articles 23 and 72 through 76 and Annex IV as conditions to internal supervision substituted compliance. These MiFID Org Reg articles relate to risk management and recordkeeping, respectively, and are addressed elsewhere in this section.

359 See SIFMA Letter at II Appendix A.

360 Id.

361 The Commission is deleting the requirements related to CRD article 93 and related implementing provisions, as they were not part of the French Authorities' Application, and relate to remuneration policies for institutions that benefit from exceptional (French and EU) government intervention.

the applicable regulatory outcome. It would be inconsistent with the holistic approach to excise relevant requirements and leave only the residual French and EU provisions that most closely resemble the analogous Exchange Act requirements.[362] In reaching this conclusion, the Commission emphasizes the importance of ensuring that substituted compliance is grounded on the comparability of regulatory outcomes.[363]

2. Compliance report certifications

Commenters requested that the standard applied to the certification of required compliance reports upon their submission to the Commission be revised to conform more closely with the requirements set forth in Exchange Act rule 15Fk-1.[364] 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."[365] The standard applied in the proposed Order required certification that "under penalty of law, the report is accurate and complete."[366] The Commission concurs that alignment of the Order's certification requirement with that of the applicable Exchange Act rule is appropriate in this instance. Therefore, the Order has been updated to 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 applies.[367]

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362 The Commission believes that those conditions to substituted compliance do not "expand the substantive ambit of the linked Exchange Act requirements" given that substituted compliance is an option available to non-U.S. SBS Entities – not a mandate.

363 See Better Markets Letter at 3 (addressing need for a "compelling showing" of comparability).

364 See SIFMA Letter I at 7 n.14; SIFMA Letter II at 19 (stating that "paragraph (d)(2)(ii)(B) of the French Order should be conformed to be consistent with the linked Exchange Act requirement."); see also FBF Letter at 3 (stating that "the attestation language a bank would need to use when furnishing home country reports is stricter than that required under the SEC rule itself.").

365 See 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").

366 French Substituted Compliance Notice and Proposed Order, 81 FR at 85740.

367 See para. (d)(2)(ii)(B) of the Order.

In addition, the Order has been updated to clarify that the certification must cover compliance with applicable Exchange Act requirements, consistent with the requirements regarding internal supervision.[368] The Commission believes that this clarification is necessary, particularly in light of its granular approach to substituted compliance, to ensure that the report covers applicable Exchange Act requirements whether or not the SBS Entity relies on substituted compliance for internal supervision.

3. Timing of compliance report submission

Commenters requested that the Order be amended to clarify the timing for Covered Entities to submit compliance reports to the Commission, and suggested standards by which "the Covered Entity may make an annual submission of this report 15 days after submission to the AMF."[369] One commenter explained that absent such a clarification, submission of the report seemingly would be required within 30 days following the deadline for the Covered Entity to file its annual financial report with the Commission, without regard to when the entity prepares its report pursuant to MiFID.[370] Another commenter stated that providing a clarified 15 day timeline would accommodate "the need to account for translation as well as other conditions in the French Order."[371]

The Commission is persuaded that additional clarification is warranted, concurs that it is appropriate for the Commission to receive compliance reports shortly after their preparation, and views 15 days as providing a reasonable time to translate and convey reports. At the same time,

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368 See para. (d)(4) of the Order.

369 See SIFMA Letter II at 19-20; see also FBF Letter II at 3 (requesting that the report be submitted to the SEC "15 days after its submission to the AMF in April each year"). With regard to the UK Substituted Compliance Notice and Proposed Order, SIFMA supported a single annual submission for multiple reports without reference to a 15 day timing standard. See SIFMA UK Letter at 21.

370 SIFMA Letter II at 19-20, 31. The "15 days after submission to the AMF" language is incorporated into the commenter's "detailed recommendations" (at page 31). The commenter's general discussion of the issue separately alludes to a "15 days after the Covered Entity completes its annual MiFID report as required by MiFID" standard (at page 20).

371 FBF Letter II at 3.

the Commission does not believe that the suggested "15 days after submission to the AMF" standard sets forth an optimal timing condition, in part given that MiFID Org Reg article 22(2)(c) requires reports to the firm management body – not to authorities such as the AMF.

Instead, to promote timely notice comparable to what the Exchange Act rule provides, the Commission is incorporating 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 Order, the applicable compliance reports are to 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.[372] In addition, reports required to be provided under MiFID Org Reg article 22(2)(c) must together cover the entire period that an Exchange Act rule 15Fk-1 annual report would have covered. This requirement would prevent a Covered Entity from applying for substituted compliance just prior to the due date of its Exchange Act annual report and then providing the Commission its next MiFID Org Reg report covering only a part of the year that would have been covered in the Exchange Act report.

4. Compliance reports subject to disclosure

One commenter requested that the proposed Order be modified to narrow the scope of the compliance reports provided to the Commission, stating that the conditions to substituted compliance should require that the Commission be provided with the compliance reports only "to the extent they are related to a Covered Entity's business as an SBS Entity."[373] The commenter argued that it would be "disproportionate and unnecessary" to require that the Commission receive all reports prepared pursuant to MiFID Org Reg article 22(2)(c).[374]

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372 See para. (d)(2)(ii)(D) of the Order.

373 SIFMA Letter II at 19.

374 Id.

The Commission disagrees, and believes that the Commission should be fully informed – consistent with the scope of MiFID Org Reg article 22(2)(c) – as to the "implementation and effectiveness" of the Covered Entity's "overall control environment for investment services and activities," as well as associated risks, complaints handling and remedies. The alternative approach of apportioning compliance reports into two buckets, and only providing one bucket to the Commission, does not match the analytic approach of considering the Exchange Act and French/EU frameworks "as a whole."

5. Compliance conditions related to recordkeeping

The Commission also is not adopting a commenter's suggestion that MiFID Org Reg articles 72 through 76 and Annex IV recordkeeping requirements be removed from the conditions for substituted compliance for internal supervision and compliance.[375] Documentation is an important component of an effective compliance system, and a firm that has failed to comply with relevant EU recordkeeping requirements cannot reasonably be viewed as having engaged in supervisory and compliance practices that are sufficiently rigorous to satisfy the regulatory outcome established by the relevant requirements under the Exchange Act.

6. Additional considerations and final Order provisions

For these reasons, the Commission is adopting the requirements related to internal supervision and compliance largely as proposed, subject to the specific changes addressed above.[376] Consistent with the proposed Order, substituted compliance in connection with internal supervision further is conditioned on the Covered Entity being subject to and complying with the applicable French and EU supervisory and compliance provisions listed in paragraph (d)(3) of the Order, as if those provisions also require SBS Entities to comply with applicable

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375 SIFMA Letter I at 6-7.

376 See para. (d)(3) of the Order. Consistent with the discussion above related to internal risk management (part IV.B.1), the condition has been modified from the proposed Order by removing Prudential Supervision and Risk Assessment Order article 7.

requirements under the Exchange Act and the other applicable conditions to the Order.[377] Similarly, substituted compliance in connection with the chief compliance officer requirements further is conditioned on the compliance reports provided to the Commission addressing the SBS Entity's compliance with other applicable conditions of the Order.[378] A Covered Entity that is unable to comply with an applicable condition—and thus is not eligible to use substituted compliance for the Exchange Act internal supervision and/or chief compliance officer requirements related to that condition—nevertheless may use substituted compliance for another set of Exchange Act requirements addressed in the Order if it complies with the conditions to the relevant parts of the Order.

Under the Order, substituted compliance for internal supervision and chief compliance officer requirements is not subject to a condition that the Covered Entity apply substituted compliance for related recordkeeping requirements in Exchange Act rules 18a-5 and 18a-6. A Covered Entity that applies substituted compliance for internal supervision and/or chief compliance officer requirements, but does not apply substituted compliance for the related recordkeeping requirements in Exchange Act rules 18a-5 and 18a-6, will remain subject to the relevant provisions of Exchange Act rules 18a-5 and 18a-6. Those rules require the Covered Entity to make and preserve records of its compliance with Exchange Act internal supervision and chief compliance officer requirements and of its security-based swap activities required or governed by those requirements. A Covered Entity that applies substituted compliance for internal supervision and/or chief compliance officer requirements, but complies directly with related recordkeeping requirements in rules 18a-5 and 18a-6, therefore must make and preserve

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377 See para. (d)(4) of the Order. The Order provides that the Covered Entity must comply with relevant French and EU provisions as if those provisions address applicable conditions of the Order connected to requirements for which the Covered Entity is relying on substituted compliance. That part of the condition does not apply to parts of the Order for which the Covered Entity does not rely on substituted compliance.

378 See para. (d)(2)(ii) of the Order. For the reasons discussed in the proposal, the substituted compliance Order does not extend to antitrust provisions under the Exchange Act.

records of its compliance with the relevant conditions of the Order and of its security-based swap activities required or governed by those conditions and/or referenced in the relevant parts of rules 18a-5 and 18a-6.

Finally, for the reasons discussed in the proposed Order, moreover, the substituted compliance Order does not extend to antitrust provisions under the Exchange Act.[379]

VII. Substituted Compliance for Counterparty Protection Requirements

A. Proposed approach

The French Authorities' Application in part requested substituted compliance in connection with counterparty protection requirements relating to:

- Disclosure of material risks and characteristics and material incentives or conflicts of interest – Requirements that an SBS Entity disclose to certain security-based swap counterparties certain information about the material risks and characteristics of the security-based swap, as well as material incentives or conflicts of interest that the SBS Entity may have in connection with the security-based swap.
- "Know your counterparty" – Requirements that an SBS Entity establish, maintain and enforce written policies and procedures to obtain and retain certain information regarding a security-based swap counterparty that is necessary for conducting business with that counterparty.
- Suitability – Requirements for a security-based swap dealer to undertake reasonable diligence to understand the potential risks and rewards of any recommendation of a security-based swap or trading strategy involving a security-based swap that it makes to certain counterparties and to have a reasonable basis to believe that the recommendation is suitable for the counterparty

[379] See French Substituted Compliance Notice and Proposed Order, 85 FR at 85728.

- Fair and balanced communications – Requirements that an SBS Entity communicate with security-based swap counterparties in a fair and balanced manner based on principles of fair dealing and good faith.
- Daily mark disclosure – Requirements that an SBS Entity provide daily mark information to certain security-based swap counterparties.
- Clearing rights disclosure – Requirements that an SBS Entity provide certain counterparties with information regarding clearing rights under the Exchange Act.

Taken as a whole, these counterparty protection requirements help to "bring professional standards of conduct to, and increase transparency in, the security-based swap market and to require registered SBS Entities to treat parties to these transactions fairly."[380]

The proposed Order provided for conditional substituted compliance in connection with fair and balanced communications, disclosure of material risks and characteristics, disclosure of material incentives or conflicts of interest, "know your counterparty," suitability and daily mark disclosure requirements.[381] In proposing to provide conditional substituted compliance for these requirements, the Commission preliminarily concluded that the relevant French and EU requirements in general would produce regulatory outcomes that are comparable to requirements under the Exchange Act, by subjecting French Covered Entities to obligations that promote standards of professional conduct, transparency and the fair treatment of parties.

As proposed, substituted compliance for these requirements would be subject to certain conditions to help ensure the comparability of outcomes. First, under the proposed Order, substituted compliance for fair and balanced communications, disclosure of material risks and characteristics, disclosure of material incentives or conflicts of interest, "know your counterparty," and suitability requirements would be conditioned on Covered Entities being

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380 See Business Conduct Adopting Release, 81 FR at 30065.

381 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85728-29.

subject to, and complying with, relevant French and EU requirements.[382] Second, the proposed Order would additionally condition substituted compliance for suitability requirements on the counterparty being a "professional client" as defined in MiFID (rather than a "retail client" or an elective "professional client"[383]) and not a "special entity" as defined in Exchange Act section 15F(h)(2)(C) and Exchange Act rule 15Fh-2(d).[384] Finally, in the proposed Order the Commission preliminarily viewed certain types of EU daily portfolio reconciliation requirements as comparable to Exchange Act daily mark disclosure requirements.[385] These daily portfolio reconciliation requirements apply to portfolios of a financial counterparty or a non-financial counterparty subject to the clearing obligation in EMIR in which counterparties have 500 or more OTC derivatives contracts outstanding with each other.[386] The Commission preliminarily viewed EU portfolio reconciliation requirements for other types of portfolios, which may be reconciled less frequently than each business day or may not require disclosure to counterparties, as not comparable to Exchange Act daily mark requirements.[387] Accordingly, the proposed Order would condition substituted compliance for daily mark requirements on the Covered Entity being required to reconcile, and in fact reconciling, the portfolio containing the relevant security-based swap on each business day and exchanging valuations of those contracts directly between counterparties, pursuant to relevant EU requirements.[388]

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382 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85729 n.72.

383 Annex II of MiFID describes which clients are "professional clients." Section I of Annex II describes the types of clients considered to be professional clients unless the client elects non-professional treatment; these clients are per se professional clients. Section II of Annex II describes the types of clients who may be treated as professional clients on request; these clients are elective professional clients. See MiFID Annex II. Retail clients are those that are not professional clients. See MiFID article 4(1)(11).

384 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85730.

385 Id. at 85729-85730.

386 See EMIR RTS article 13(3)(a)(i); EMIR article 10.

387 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85730.

388 Id.

The Order would not provide substituted compliance in connection with Exchange Act requirements for SBS Entities to disclose a counterparty's clearing rights under Exchange Act section 3C(g)(5). The French Authorities' Application cited certain EU provisions related to a counterparty's clearing rights in the European Union. However, those provisions do not require disclosure of Exchange Act section 3C(g)(5) clearing rights, and the Commission preliminarily viewed the EU clearing provisions as not comparable to Exchange Act clearing rights disclosure requirements.[389]

B. Commenter views and final provisions

Having considered the commenter recommendations for the counterparty protection requirements, the Commission is making positive substituted compliance determinations in connection with disclosure of material risks and characteristics, disclosure of material incentives or conflicts of interest, "know your counterparty," suitability, fair and balanced communications and daily mark disclosure requirements. The Order is largely consistent with the proposed Order, except for adding additional EU requirements in two sections of the Order, moving one EU requirement from the fair and balanced communications section of the Order to the disclosure of material incentives and conflicts of interest section and adding text to clarify that substituted compliance for counterparty protection requirements is applied at the transaction level.[390] This action is grounded in the Commission's conclusion that, taken as a whole, applicable requirements under French and EU law subject French Covered Entities to obligations that promote standards of professional conduct, transparency and the fair treatment of parties, and thus produce regulatory outcomes that are comparable to the outcomes associated with the relevant counterparty protection requirements under the Exchange Act.

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389 Id.

390 See para. (e) of the Order.

To help ensure the comparability of outcomes, substituted compliance is subject to certain conditions. Substituted compliance for disclosure of material risks and characteristics,[391] disclosure of material incentives or conflicts of interest,[392] "know your counterparty",[393] suitability[394] and fair and balanced communications[395] requirements is conditioned on a Covered Entity being subject to, and complying with, relevant French and EU requirements. Substituted compliance for daily mark disclosure requirements is conditioned on the Covered Entity being required to reconcile, and in fact reconciling, the portfolio containing the relevant security-based swap on each business day pursuant to relevant EU requirements.[396] Substituted compliance for suitability requirements is conditioned on the counterparty being a per se "professional client" as defined in MiFID (i.e., not an elective professional client or a retail client) and not a "special entity" as defined in Exchange Act section 15F(h)(2)(C) and Exchange Act rule 15Fh-2(d).[397] A Covered Entity that is unable to comply with a condition—and thus is not eligible to use substituted compliance for the particular set of Exchange Act counterparty protection requirements related to that condition—nevertheless may use substituted compliance for another set of Exchange Act requirements addressed in the Order if it complies with the conditions to the relevant parts of the Order.

The Commission recognizes that there are differences between the approaches taken by disclosure of material risks and characteristics, disclosure of material incentives or conflicts of interest, "know your counterparty," suitability, fair and balanced communications and daily mark

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391 See para. (e)(1) of the Order.

392 See para. (e)(2) of the Order.

393 See para. (e)(3) of the Order.

394 See para. (e)(4)(i) of the Order.

395 See para. (e)(5) of the Order.

396 Covered Entities must be required to reconcile, and in fact reconcile, the portfolio containing the security-based swap for which substituted compliance is applied, on each business day pursuant to EMIR articles 11(1)(b) and 11(2) and EMIR RTS article 13. See para. (e)(6) of the Order.

397 See para. (e)(4)(ii) of the Order.

disclosure requirements under the Exchange Act, on the one hand, and relevant French and EU requirements, on the other hand. The Commission continues to view those differences, when coupled with the conditions described above, as not so material as to be inconsistent with substituted compliance within the requisite outcomes-oriented context. With respect to Exchange Act clearing rights disclosure requirements, however, consistent with the proposed Order the Commission is not providing substituted compliance.

Under the Order, substituted compliance for counterparty protection requirements (relating to disclosure of information regarding material risks and characteristics, disclosure of information regarding material incentives or conflicts of interest, "know your counterparty," suitability, fair and balance communications and daily mark disclosure) is not subject to a condition that the Covered Entity apply substituted compliance for related recordkeeping requirements in Exchange Act rules 18a-5 and 18a-6. A Covered Entity that applies substituted compliance for one or more counterparty protection requirements, but does not apply substituted compliance for the related recordkeeping requirements in Exchange Act rules 18a-5 and 18a-6, will remain subject to the relevant provisions of Exchange Act rules 18a-5 and 18a-6. Those rules require the Covered Entity to make and preserve records of its compliance with Exchange Act counterparty protection requirements and of its security-based swap activities required or governed by those requirements. A Covered Entity that applies substituted compliance for a counterparty protection requirement, but complies directly with related recordkeeping requirements in rules 18a-5 and 18a-6, therefore must make and preserve records of its compliance with the relevant conditions of the Order and of its security-based swap activities required or governed by those conditions and/or referenced in the relevant parts of rules 18a-5 and 18a-6.

One commenter requested that the Commission make several changes to the conditions in the proposed Order.[398] The Commission details its response to each of those requests below.

1. Disclosure of information regarding material risks and characteristics

The commenter requested that the Commission not require a Covered Entity to be subject to and comply with MIFID Org Reg articles 49 and 50 and requested that the requirement for a Covered Entity to be subject to and comply with MiFID article 24(4) and MFC D. 533-15 be narrowed to include only MiFID article 24(4)(b) and MFC D. 533-15.2°, respectively.[399] The commenter described the proposed removal of conditions as addressing requirements "which do not correspond to, and go beyond, the requirements in Exchange Act rule 15Fh-3(b)."[400]

The commenter stated that MiFID Org Reg article 49 relates to information about the safeguarding of client financial instruments or client funds and thus goes beyond the scope of Exchange Act material risks and characteristics disclosure requirements.[401] This provision would require a Covered Entity to inform its client about the risks of the Covered Entity placing client assets, which would include the relevant security-based swap and funds related to it, to be held by a third party, the risks of the Covered Entity holding client assets in an omnibus account, the risks of holding client assets that are not segregated from the assets of the Covered Entity or a third party holding the client's assets and the risks of the Covered Entity entering into securities financing transactions using client assets. A Covered Entity also would have to inform the client when the relevant security-based swap is held in an account subject to the laws of a jurisdiction other than France and indicate that client rights relating to the security-based swap may differ from those under French law. A Covered Entity also would have to inform the client about any security interest, lien or right of set-off that the Covered Entity or a depository may have over

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398 See SIFMA Letter II at Appendix A.

399 Id.

400 Id.

401 Id.

client assets. In comparison, Exchange Act rule 15Fh-3(b)(1) requires a Covered Entity, before entering into a security-based swap, to disclose to certain counterparties material information about the security-based swap in a manner reasonably designed to allow the counterparty to assess the material risks and characteristics of the security-based swap, which may include market, credit, liquidity, foreign currency, legal, operational and any other applicable risks of the security-based swap. Legal and operational risks of a security-based swap include the types of risks to client assets that MiFID Org Reg article 49 would require the Covered Entity to disclose. Accordingly, the Commission is retaining the references to these provisions.

The commenter stated that MiFID Org Reg 50 relates to the disclosure of costs and charges and thus goes beyond the scope of Exchange Act material risks and characteristics disclosure requirements.[402] Exchange Act rule 15Fh-3(b)(1) requires a Covered Entity, before entering into a security-based swap, to disclose to certain counterparties material information about the security-based swap in a manner reasonably designed to allow the counterparty to assess the material risks and characteristics of the security-based swap, which may include the material economic terms of the security-based swap and the rights and obligations of the parties during the term of the security-based swap. The material economic terms of a security-based swap and the rights and obligations of the parties include the costs and charges associated with the security-based swap. Accordingly, the Commission is retaining the references to these provisions.

Additionally, the commenter requested that MiFID article 24(4) and MFC D. 533-15 be narrowed to only require compliance with MiFID article 24(4)(b) and MFC D. 533-15.2°, because the parts proposed for removal "relate[] to whether the advice is provided on an independent basis and… to costs and charges."[403] As noted above, Exchange Act rule 15Fh-3(b)(1) requires a Covered Entity, before entering into a security-based swap, to disclose to

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402 Id.

403 Id.

certain counterparties material information about the security-based swap in a manner reasonably designed to allow the counterparty to assess the material risks and characteristics of the security-based swap, which may include the material economic terms of the security-based swap and the rights and obligations of the parties during the term of the security-based swap. The Commission believes that a counterparty would consider the independence of the Covered Entity in the counterparty's assessment of these risks and characteristics. The Commission addressed the provisions related to costs and charges above. The holistic approach taken by the Commission in considering whether regulatory requirements are comparable further warrants the inclusion of these provisions in the Order. Accordingly, the Commission is retaining the references to these provisions.

2. Disclosure of information regarding material incentives or conflicts of interest

The commenter requested that the Commission not require a Covered Entity to be subject to and comply with MiFID article 24(9) and MFC L. 533-12-4.[404] The commenter stated that these provisions relate to third-party payments and thus go beyond the scope of Exchange Act material incentives or conflicts of interest disclosure requirements. These provisions would require a Covered Entity to refrain from paying to, or accepting from, third parties certain fees, commissions or non-monetary benefits in connection with providing an investment service (inducements) and, in circumstances in which the general prohibition on inducements does not apply, to disclose to the client the existence, nature and amount of the inducement prior to providing the service and in a manner that is comprehensive, accurate and understandable. In comparison, Exchange Act rule 15Fh-3(b)(2) requires a Covered Entity, before entering into a security-based swap, to disclose to certain counterparties material information about the security-based swap in a manner reasonably designed to allow the counterparty to assess the material incentives or conflicts of interest that the Covered Entity may have in connection with the

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404 Id.

security-based swap, including any compensation or other incentives from any source other than the counterparty. Disclosure of this compensation or other incentives would include disclosure of the existence, nature and amount of an inducement that MiFID article 24(9) and MFC L. 533-12-4 would require the Covered Entity to disclose. Accordingly, the Commission is retaining the references to these provisions.

The Commission is issuing the disclosure of information regarding material incentives or conflicts of interest section of the Order largely as proposed, with the inclusion of two additional EU requirements.[405] 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 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 French and EU requirements produce regulatory outcomes that are comparable to relevant requirements of Exchange Act rule 15Fh-3(b). Accordingly, the Commission is adding these two requirements to the Order's list of French and EU disclosure of information regarding material incentives or conflicts of interest requirements that the Covered Entity must be subject to and comply with.[406]

3. "Know your counterparty"

The commenter requested that the Commission not require a Covered Entity to be subject to and comply with a series of French and EU "know your counterparty" requirements specified

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405 See para. (e)(2) of the Order.

406 See id.

in the proposed Order, including: MiFID article 16(2); MFC L. 533–10.II(2); MiFID Org Reg articles 21 and 22, 25 and 26 and applicable parts of Annex I; CRD articles 74(1) and 85(1); MFC L. 511-55 and L. 511-41-1-B; MLD articles 11 and 13; L. 561-6, L. 561-10, L. 561-4-1, R. 561-5-2, R. 561-7, R. 561-10-3, R. 561-11-1; MLD articles 8(3) and 8(4)(a) as applied to internal policies, controls and procedures regarding recordkeeping of customer due diligence activities; and MFC L. 561-4-1 as applied to vigilance measures regarding recordkeeping of customer due diligence activities.[407] The commenter also proposed the addition of MFC article L. 561-12 to the Order's "know your counterparty" conditions. Similar to other elements of the counterparty protection requirements, the commenter asserted that the conditions identified for removal "do not correspond to, and go beyond, the requirements of Exchange Act rule 15Fh-3(e)."[408] However, the commenter's reasons for this overarching claim are unconvincing.

The commenter describes MiFID article 16(2) and MFC L. 533-10.II(2) as relating to "broad organizational requirements" without explaining how such characteristics preclude their inclusion when considering whether regulatory requirements are comparable for purposes of substituted compliance.[409] MiFID article 16(2) requires a Covered Entity to establish, implement and maintain adequate policies and procedures sufficient to ensure the Covered Entity's compliance with its obligations under French financial services laws. This requirement relates to the requirement in Exchange Act rule 15Fh-3(e)(1) and (2) for the Covered Entity to establish, maintain and enforce written policies and procedures to obtain and retain a record of the essential facts about the counterparty that are necessary for complying with applicable laws, regulations and rules and for implementing the Covered Entity's credit and operational risk management policies. Accordingly, the Commission is retaining the references to these provisions.

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407 SIFMA Letter II at Appendix A.

408 Id.

409 Id.

The commenter similarly describes the other conditions proposed for removal, including the MiFID Org Reg articles as "organizational requirements, compliance, responsibility of senior management, complaints handling and associated recordkeeping."[410] However, MiFID Org Reg articles 21, 22, 25, 26 and applicable parts of Annex I are regulations that implement MiFID article 16(2). They provide additional detail about the Covered Firm's required policies and procedures under the French regulatory framework, and as such are relevant to the policies and procedures required under Exchange Act rule 15Fh-3(e). Accordingly, the Commission is retaining the references to these provisions.

The commenter states that CRD articles 74(1) and 85(1), and MFC L. 511–55 and L. 511-41-1-B are "governance and prudential requirements," and thus go beyond the scope of Exchange Act "know your counterparty" requirements.[411] CRD article 74(1) would require the Covered Entity to have robust governance arrangements, including effective processes to identify, manage, monitor and report the risks it is or might be exposed to. CRD article 85(1) would require the Covered Entity to implement policies and processes to evaluate and manage the exposures to operational risk. These requirements relate to the requirement in Exchange Act rule 15Fh-3(e)(2) for the Covered Entity to establish, maintain and enforce written policies and procedures to obtain and retain a record of the essential facts about the counterparty that are necessary for implementing the Covered Entity's credit and operational risk management policies. Accordingly, the Commission is retaining the references to these provisions.

The commenter states that MLD articles 8(3), 8(4)(a), 11 and 13, are simply "overbroad," and therefore "do not correspond to, and go beyond, the requirements of Exchange Act rule 15Fh-3(e)."[412] Similarly, the commenter states that MFC articles L. 561-6, L. 561-10, R. 561-5-2, R. 561-7, R. 561-10-3 and R. 561-11-1, which in part implement MLD articles 11 and 13, and

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410 Id.

411 Id.

412 Id.

MFC article L. 561-4-1, which implements MLD articles 8(3) and 8(4)(a), are related to "AML requirements other than KYC" and that "it is not appropriate for the Commission effectively to expand the scope and content of its requirements."[413] MLD articles 11 and 13, and the corresponding provisions of the MFC, require obliged entities such as a Covered Entity to apply customer due diligence measures at defined points of a business relationship. Those customer due diligence measures include verifying that any person purporting to act on behalf of a customer is so authorized. The customer due diligence measures required by MLD articles 11 and 13 and the corresponding provisions of the MFC thus are directly related to the requirement in Exchange Act 15Fh-3(e)(3) for a Covered Entity to establish, maintain and enforce written policies and procedures to obtain and retain a record of the essential facts about the authority of any person acting for a counterparty. MLD articles 8(3) and 8(4)(a) and MFC article L. 561-4-1 would require a Covered Entity to have in place policies, controls and procedures to mitigate and manage effectively the risks of money laundering and terrorist financing. These policies and processes are related to the requirement in Exchange Act rule 15Fh-3(e)(1) and (2) for the Covered Entity to establish, maintain and enforce written policies and procedures to obtain and retain a record of the essential facts about the counterparty that are necessary for complying with applicable laws, regulations and rules and for implementing the Covered Entity's credit and operational risk management policies. Accordingly, the Commission is retaining the references to these provisions.

The commenter provided no rationale for the proposed inclusion of MFC L. 561-12. Accordingly, the Commission is not adding this provision to the Order.

4. Suitability

The commenter requested that the Commission not require a Covered Entity to be subject to and comply with some of the French and EU suitability requirements specified in the proposed

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413 Id.

Order, including: MiFID articles 24(3) and 25(1); MFC L. 533-24, L. 533-12(I), and L. 533-12-6; and MiFID Org Reg articles 21(1)(b) and (d). The commenter stated that each of these recommended deletions, "do not correspond to, and go beyond, the requirements in Exchange Act rule 15Fh-3(f)."[414] The commenter stated that MiFID article 24(3) and MFC article L. 533-12(I) "relate to the requirement that any information communicated to clients is fair, clear and not misleading"; that MiFID article 25(1), MFC article L. 533-12-6, and MiFID Org Reg article 21(1)(d) "refer to the skills, knowledge and expertise of the firm's personnel"; that MFC article L. 533-24 "relates to obligations imposed on firms who design financial instruments"; and that MiFID Org Reg article 21(1)(b) requires "that relevant persons are aware of the procedures which must be followed for the proper discharge of their responsibilities."[415]

Exchange Act rule 15Fh-3(f) requires an SBS Entity, when making certain security-based swap recommendations to a counterparty, to undertake reasonable diligence to understand the potential risks and rewards associated with the recommendation (the reasonable basis suitability standard) and to have a reasonable basis to believe that the recommendation is suitable for the counterparty (the counterparty-specific suitability standard).[416] MiFID article 25(1) and MFC article L. 533-12-6 would require a Covered Entity to ensure that individuals making personal recommendations to clients in relation to a relevant security-based swap have the necessary knowledge and competence so as to ensure that the Covered Entity is able to meet its obligations under MiFID articles 24 and 25 and the related provisions of the MiFID Org Reg. MiFID article 25(2) and MFC article L. 533-13(I) would require the Covered Entity to obtain information about a client necessary to ensure that it makes only recommendations that are suitable for the client, and thus are relevant to the Exchange Act counterparty-specific suitability standard. Thus, MiFID article 25(1) and MFC article L. 533-12-6 would require the Covered Entity to

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414 Id.

415 Id.

416 See Exchange Act rule 15Fh-3(f)(1).

ensure that recommendations to clients are made with the knowledge and competence necessary to fulfill the Covered Entity's obligation under MiFID article 25(1) and MFC article L. 533-12-6 to make only suitable recommendations. This knowledge and competence requirement in MiFID article 25(1) and MFC article L. 533-12-6 is directly related to the Exchange Act reasonable basis standard.

Moreover, MiFID article 24(3) and MFC Article L. 533-12(I), are particularly relevant to the Exchange Act reasonable basis standard. MiFID article 24(3), together with MiFID article 25(1), would require the Covered Entity to ensure that individuals making recommendations have the knowledge and competence to communicate about the relevant security-based swap in a way that is fair, clear and not misleading. The Commission believes that in order to meet the French requirement to communicate in a fair, clear, and not misleading manner, the Covered Entity's due diligence would reflect that individuals engaged in such communication understand the potential risks and rewards of the recommendation in a manner that is comparable to the requirement in Exchange Act rule 15Fh-3(f)(1)(i). MiFID Org Reg article 21(1)(b) and (d), in turn, would require the Covered Entity to ensure that its personnel have the skills, knowledge and expertise, and be aware of the procedures, necessary to properly discharge their responsibilities, which include their suitability obligations. These requirements again relate to the Exchange Act reasonable basis standard because they would require the Covered Entity to ensure that personnel making recommendations are equipped with the requisite training and information to be able to properly communicate about the relevant security-based swap in a way that complies with its French and EU communication and suitability obligations. For these reasons, the Commission is retaining in the Order the references to the French and EU requirements that the commenter asked to delete.[417]

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[417] See para. (e)(4)(i) of the Order.

Additionally, the commenter requested that the Commission change the condition to substituted compliance for Exchange Act suitability requirements that would require the Covered Entity's counterparty to be a "professional client" mentioned in MiFID Annex II section I and MFC article D. 533-11.[418] Professional clients mentioned in MiFID Annex II section I and MFC article D. 533-11 are per se professional clients, a category of clients that generally includes those with more experience, knowledge, expertise and resources and that excludes elective professional clients and retail clients. The commenter requested that the Commission expand the condition's definition of "professional client" to include elective professional clients mentioned in MiFID Annex II section II and MFC article D. 533-12.[419] Elective professional clients generally have less experience, knowledge, expertise and/or resources than per se professional clients.[420] Because French and EU suitability requirements permit a Covered Entity, when conducting a suitability analysis for elective professional clients, to make certain assumptions,[421] while the Exchange Act permits a similar mechanism only for institutional counterparties, the Commission believes that French and EU suitability requirements are comparable only with respect to per se professional clients.[422] Accordingly, the Commission is retaining the condition requiring the Covered Entity's counterparty to be a per se professional client and is not expanding that condition to permit Covered Entities to apply substituted compliance for Exchange Act suitability requirements when its counterparty is an elective professional client.

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418 SIFMA Letter II at Appendix A.

419 Id.

420 See MiFID Annex II section II.1. (stating that elective professional clients "shall not, however, be presumed to possess market knowledge and experience comparable to that of the categories listed in Section I.").

421 See, e.g., MiFID Org Reg article 54(3).

422 See para. (e)(4) of the Order.

5. Fair and balanced communications

The Commission is issuing the fair and balanced communications section of the Order largely as proposed, except for two changes.[423] First, the Commission believes that French 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 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 French and EU fair and balanced communications requirements that the Covered Entity must be subject to and comply with.[424] Second, the proposed Order would have required the Covered Entity to be subject to and comply with MAR Investment Recommendations Regulation article 5,[425] 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

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423 See para. (e)(5) of the Order.

424 See para. (e)(5) of the Order.

425 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85741.

Commission believes that MAR Investment Recommendations Regulation article 5 is less relevant to comparability of fair and balanced communications requirements and is deleting the reference to it in relation to substituted compliance for fair and balanced communications.

The Commission did not receive comments on the fair and balanced communications requirements of the counterparty protection section of the proposed Order.

6. Daily mark disclosure

A commenter requested that the Commission not require a Covered Entity to be subject to and comply with EMIR article 11(2), stating that it "is not related to portfolio reconciliation", but, rather, "concerns the daily mark-to-market or mark-to-model of contracts."[426] The commenter is correct that EMIR article 11(2) would require the Covered Entity to mark-to-market or mark-to-model its non-centrally cleared contracts. Other French portfolio reconciliation requirements contemplate that counterparties will use this valuation as an input to the reconciliation process. For example, a portfolio reconciliation must include at least the valuation attributed to each contract in accordance with EMIR article 11(2).[427] As EMIR article 11(2) sets the standards under which a Covered Entity must calculate this key input in the portfolio reconciliation process, the Commission has determined that this provision is related to portfolio reconciliation and accordingly is retaining the Order's reference to it.[428]

7. Clearing rights disclosure

In the proposed Order, the Commission preliminarily determined that French and EU requirements are not comparable to Exchange Act clearing rights disclosure requirements and proposed not to make a positive substituted compliance determination with respect to those requirements.[429] Because French and EU clearing provisions do not require disclosure of a

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426 SIFMA Letter II at Appendix A.

427 See EMIR RTS article 13(2).

428 See para. (e)(6) of the Order.

429 French Substituted Compliance Notice and Proposed Order, 81 FR at 85730.

counterparty's clearing rights under Exchange Act section 3C(g)(5), the Commission views those provisions as not comparable to Exchange Act clearing rights disclosure requirements. Commenters did not address this conclusion and, consistent with the proposed Order, the Commission is not providing substituted compliance.

8. Clarifications related to conditions

A commenter asked the Commission to revise the Order to follow the approach in the UK Proposed Order, in which the Commission clarified that a Covered Entity may apply substituted compliance for Exchange Act rule 15Fh-3(f)'s suitability requirements to "one or more recommendations of a security-based swap or trading strategy involving a security-based swap" subject to those Exchange Act suitability requirements.[430] The commenter proposed adding this same text to the Order.[431] The UK Proposed Order contains similar text with respect to substituted compliance for the other counterparty protection requirements.

Because the counterparty protection requirements are transaction-level requirements, a Covered Entity may decide to apply substituted compliance for those requirements to some of its security-based swap business and decide to comply directly with the Exchange Act (or to comply with another suitable substituted compliance order) for other parts of its security-based swap business. The Commission agrees that the commenter's requested change would help to clarify that substituted compliance for suitability is available for one or more of a Covered Entity's recommendations and also believes that similar changes to the other counterparty protection sections of the Order, consistent with the UK Proposed Order, would clarify those sections of the Order as well. Accordingly, the Commission is modifying each paragraph of the counterparty protection section of the Order to clarify that substituted compliance for counterparty protection requirements is available for one or more of a Covered Entity's relevant activities.[432]

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430 SIFMA Letter II at Appendix A.

431 Id.

432 See paras. (e)(1) through (6) of the Order.

VIII. Substituted Compliance for Recordkeeping, Reporting, Notification, and Securities Count Requirements

A. Proposed approach

The French Authorities' Application in part requested substituted compliance for requirements applicable to SBS Entities under the Exchange Act relating to:

- Record Making – Exchange Act rule 18a-5 requires prescribed records to be made and kept current.[433]
- Record Preservation – Exchange Act rule 18a-6 requires preservation of records.[434]
- Reporting – Exchange Act rule 18a-7 requires certain reports.[435]
- Notification – Exchange Act rule 18a-8 requires notification to the Commission when certain financial or operational problems occur.[436]
- Securities Count – Exchange Act rule 18a-9 requires non-prudentially regulated security-based swap dealers to perform a quarterly securities count.[437]
- Daily Trading Records. Exchange Act section 15F(g) requires SBS Entities to maintain daily trading records.[438]

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433 See 17 CFR 240.18a-5. The French Authorities' Application discusses EU and French 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 French Authorities' Application Annex I category 2 at 2-42.

434 See 17 CFR 240.18a-6. The French Authorities' Application discusses EU and French 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 French Authorities' Application Annex I category 2 at 43-81.

435 See 17 CFR 240.18a-7. The French Authorities' Application discusses EU and French requirements that address firms' obligations to make certain reports. See French Authorities' Application Annex I category 2 at 82-95, 98-104.

436 See 17 CFR 240.18a-8. The French Authorities' Application discusses EU and French requirements that address firms' obligations to make certain notifications. See French Authorities' Application Annex I category 2 at 95-98.

437 See 17 CFR 240.18a-9. The French Authorities' Application discusses EU and French requirements that address firms' obligations to perform securities counts. See French Authorities' Application Annex I category 2 at 32-38.

438 See 15 U.S.C. 78*o*-10(g). The French Authorities' Application discusses EU and French 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 French Authorities' Application Annex I category 2 at 43-81.

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.[439]

In proposing to provide conditional substituted compliance in connection with this part of the French Authorities' Application, the Commission preliminarily concluded that the relevant EU and French requirements, subject to conditions and limitations, would produce regulatory outcomes that are comparable to the outcomes associated with the vast majority of the recordkeeping, reporting, notification, and securities count requirements under the Exchange Act applicable to SBS Entities pursuant to Exchange Act rules 18a-5, 18a-6, 18a-7, 18a-8, and 18a-9 and Exchange Act section 15F(g) (collectively, the "Exchange Act Recordkeeping and Reporting Requirements").[440]

In the Reopening Release, the Commission sought comment on whether the structure of the substituted compliance determinations with respect to Exchange Act rules 18a-5, 18a-6, 18a-7, 18a-8, and 18a-9 as well as Exchange Act Section 15F(g) should permit a covered entity to apply substituted compliance with respect to certain of these rules (e.g., Exchange Act rules 18a-5 and 18a-6) and comply with the Exchange Act requirements of the remaining rules and statute (i.e., Exchange Act rules 18a-7, 18a-8, and 18a-9, as well as Exchange Act Section 15F(g)).[441]

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439 Rule 3a71-6 sets forth additional analytic considerations in connection with substituted compliance for the Commission's recordkeeping, reporting, notification, and securities count requirements. In particular, Exchange Act rule 3a71-6(d)(6) provides that the Commission intends to consider (in addition to any conditions imposed) "whether the foreign financial regulatory system's required records and reports, the timeframes for recording or reporting information, the accounting standards governing the records and reports, and the required format of the records and reports" are comparable to applicable provisions under the Exchange Act, and whether the foreign provisions "would permit the Commission to examine and inspect regulated firms' compliance with the applicable securities laws."

440 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85731-34.

441 See Reopening Release, 86 FR at 18347-48.

Moreover, the Commission sought comment on whether the structure of the substituted compliance determinations with respect to the recordkeeping rules should provide Covered Entities with greater flexibility to select distinct requirements within the broader rules for which they want to apply substituted compliance.[442]

B. Commenter views and final provisions

1. General considerations

The Commission received comments addressing the proposed conditional substituted compliance determinations for the Exchange Act Recordkeeping and Reporting Requirements, including with respect to the potential approaches for which comment was sought in the Reopening Release.[443] The comments and the Commission's response to them are discussed below.

The Commission received comment requesting the elimination of references to EU or French requirements that do not apply to third-country branches or that apply to multiple countries' branches of an SBS Entity.[444] The same commenter suggested as another possible solution that SBS Entities be permitted to elect to comply directly with U.S. law instead of EU or French requirements.[445] Accordingly, in the Reopening Release, the Commission solicited comment on whether to structure its preliminary substituted compliance determinations for Exchange Act rules 18a-5, 18a-6, 18a-7, and 18a-8 to provide Covered Entities with greater flexibility to select which distinct requirements within the broader rules for which they want to apply substituted compliance.[446] This flexibility was intended to permit Covered Entities to

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442 Id. The Commission directed commenters to the UK Substituted Compliance Notice and Proposed Order to indicate how the approaches discussed above would be implemented in ordering language. See also UK Substituted Compliance Notice and Proposed Order, 86 FR at 18394-404, 18415-20.

443 See SIFMA Letter II at 17-18 and Appendix A.

444 See SIFMA Letter I at 2-4.

445 See SIFMA Letter I at 8-9.

446 See Reopening Release, 86 FR at 18347-48.

leverage existing recordkeeping and reporting systems that are designed to comply with the broker-dealer recordkeeping and reporting requirements on which the recordkeeping and reporting 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 or reporting rule (rather than apply substituted compliance) because it can utilize systems that its affiliated broker-dealer has implemented to comply with them.

As applied to Exchange Act rules 18a-5 and 18a-6, this approach of providing greater flexibility resulted 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 objectives of these rules – taken as a whole – is to assist the Commission in monitoring and examining for compliance with Exchange Act requirements applicable to SBS Entities as well as to promote the prudent operation of these firms.[447] The Commission preliminarily found that the comparable EU and French recordkeeping rules achieve these outcomes with respect to compliance with EU and French requirements for which positive substituted compliance determinations were made (e.g., 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, the Commission solicited comment on whether it would be appropriate to make substituted compliance determinations at this level of Exchange Act rules 18a-5 and 18a-6.[448]

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447 See, e.g., Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25194, 25199-200 (May 2, 2014).

448 See Reopening Release, 86 FR 18347. The Commission directed commenters to the UK Substituted Compliance Notice and Proposed Order to indicate how this approach would be implemented in ordering language. See also UK Substituted Compliance Notice and Proposed Order, 86 FR at 18396-404, 18415-18.

A commenter generally supported the Commission's proposed granular approach to making substituted compliance determinations.[449] The Order takes this granular approach.

The Commission's substituted compliance determinations for the Exchange Act Recordkeeping and Reporting Requirements were subject to the condition that the Covered Entity is subject to and complies with the relevant EU and French laws.[450] Further, the Commission proposed or solicited comment on limitations and additional conditions for certain of the proposed substituted compliance determinations. The limitations and conditions are discussed below as well any comments on them and the Commission's response to those comments.

First, the Commission solicited comment on not making a positive substituted compliance determination with respect to a discrete provision of the Exchange Act Recordkeeping and Reporting Requirements if it was fully or partially linked to a substantive Exchange Act requirement for which substituted compliance was not available or for which a positive substituted compliance determination was not being made.[451] The Commission linked a requirement in Exchange Act rule 18a-5 to Exchange Act rule 10b-10. A commenter pointed out that Covered Entities will not be subject to Exchange Act rule 10b-10.[452] The Commission agrees with the commenter that there are no provisions in the Exchange Act Recordkeeping and Reporting Requirements that are linked to Exchange Act rule 10b-10. Consequently, the Order does not contain this exclusion.

Aside from this modification, the Order does not extend substituted compliance to discrete Exchange Act Recordkeeping and Reporting Requirements that are linked to substantive

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449 See SIFMA Letter II at 17-18.

450 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85731-34; Reopening Release, 86 FR at 18347-48.

451 See Reopening Release, 86 FR at 18347-48 (discussing this limitation). The Commission directed commenters to the UK Substituted Compliance Notice and Proposed Order to indicate how this approach would be implemented in ordering language. See also UK Substituted Compliance Notice and Proposed Order, 86 FR at 18395, 18415-20.

452 See SIFMA Letter II at 18.

Exchange Act requirements for which there is no substituted compliance. In particular, a positive substituted compliance determination is not being 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 is not being made: (1) Exchange Act rule 15Fh-4; (2) Exchange Act rule 15Fh-5; (3) Exchange Act rule 15Fh-6; (4) Exchange Act rule 18a-2; (5) Exchange Act rule 18a-4; Exchange Act rule 18a-7(i); and (6) Regulation SBSR.

In addition, Exchange Act rule 18a-6(c) in part requires firms to preserve Forms SBSE, SBSE-A, SBSE-C, SBSE-W, all amendments to these forms, and all other licenses or other documentation showing the firm's registration with any securities regulatory authority or the U.S. Commodity Futures Trading Commission. Because these requirements are linked to the Commission's and other U.S. regulators' registration rules, for which substituted compliance is not available, the Order excludes the requirement to preserve these records from the Commission's positive substituted compliance determination with respect to Exchange Act rule 18a-6(c).[453]

Second, the Commission did not make a positive substituted compliance determination with respect to the inspection requirement of Exchange Act section 15F(f) and the records production the requirement of Exchange Act rule 18a-6(g).[454] The Commission did not receive comment on this approach and the Order does not extend substituted compliance to these requirements.

Third, the Commission solicited comment on conditioning substituted compliance with discrete provisions of the Exchange Act Recordkeeping and Reporting Requirements that were fully or partially linked to a substantive Exchange Act requirement for which substituted

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453 See para. (f)(2)(i)(L) of the Order.

454 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85734 (discussing this condition).

compliance was available on the Covered Entity applying substituted compliance with respect to the linked Exchange Act requirement.[455] In particular, substituted compliance for a provision of the Exchange Act Recordkeeping and Reporting Requirements that is linked to the following Exchange Act rules is conditioned on the SBS Entity applying substituted compliance to the linked substantive Exchange Act rule: (1) Exchange Act rule 15Fh-3; (2) Exchange Act rule 15Fi-2; (3) Exchange Act rule 15Fi-3; (4) Exchange Act rule 15Fi-4; (5) Exchange Act rule 15Fi-5; (6) Exchange Act rule 15Fk-1; (7) Exchange Act rule 18a-1 ("Rule 18a-1 Condition"); (8) Exchange Act rule 18a-3; (8) Exchange Act rule 18a-5; and (9) Exchange Act rule 18a-7. The Commission did not receive comment on this approach and is adopting it in the Order. The only difference is that the positive substituted compliance determination for Exchange Act rule 18a-6(b)(1)(viii) is now conditioned on the Covered Entity applying 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, rather than on the entirety of Exchange Act rule 18a-7, to reflect that substituted compliance with respect to Exchange Act rule 18a-7 is granted on a paragraph-by-paragraph basis and not all paragraphs of Exchange Act rule 18a-7 are pertinent to Exchange Act rule 18a-6(b)(1)(viii).

Moreover, for the reasons discussed above in part III.B.2.e. of this release, substituted compliance with respect to paragraphs (a)(1), (b), and (c) through (h) of Exchange Act rule 18a-7 is subject to the additional condition that the Covered Entity applies substituted compliance with respect to Exchange Act rule 18a-6(b)(1)(viii) (a record preservation requirement).[456] 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. The UK

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455 See Reopening Release, 86 FR at 18348 (discussing this condition). The Commission directed commenters to the UK Substituted Compliance Notice and Proposed Order to indicate how this approach would be implemented in ordering language. See also UK Substituted Compliance Notice and Proposed Order, 86 FR 18395, 18415-20.

456 See para. (f)(3)(i)(D) of the Order.

Proposed Order conditioned substituted compliance with respect to this record preservation requirement on the Covered Entity applying substituted compliance with respect to Exchange Act rule 18a-7(a)(1).[457] This additional condition is 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 this Order.

Fourth, the Commission conditioned substituted compliance with discrete provisions of the Exchange Act Recordkeeping and Reporting Requirements that would be important for monitoring or examining compliance with the capital rule for nonbank security-based swap dealers on the Covered Entity applying substituted compliance with respect to the capital rule (i.e., the Rule 18a-1 Condition).[458] The Commission did not receive comment on this aspect of the Reopening Release and the Order includes the Rule 18a-1 condition for discrete provisions of the Exchange Act Recordkeeping and Reporting Requirements that would be important for monitoring or examining compliance with the capital rule for nonbank security-based swap dealers, as proposed.[459]

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457 See UK Substituted Compliance Notice and Proposed Order, 86 FR at 18399, 18417. The Commission sought comment in the Reopening Release on whether this approach should be taken in the final Order. See Reopening Release, 86 FR at 18348.

458 See Reopening Release, 86 FR at 18348 (discussing this condition). The Commission directed commenters to the UK Substituted Compliance Notice and Proposed Order to indicate how this approach would be implemented in ordering language. See also UK Substituted Compliance Notice and Proposed Order, 86 FR 18395, 18415-20.

459 The Commission included the Rule 18a-1 condition in the UK Substituted Compliance Notice and Proposed Order as part of the substituted compliance determination for the daily trading records requirement of Exchange Act section 15F(g). UK Substituted Compliance Notice and Proposed Order, 86 FR at 18420. A commenter asked that the condition be modified so that it applies only if the Covered Entity is not prudentially regulated (and therefore subject to Rule 18a-1). SIFMA UK Letter at 23. Instead, the Commission has determined to delete this condition from the substituted compliance determination with respect to Exchange Act section 15F(g) generally because the requirements of Exchange Act section 15 F(g) are not important for monitoring or examining for compliance with Exchange Act rule 18a-1. Therefore, all Covered Entities – whether or not subject to Exchange Act rule 18a-1 – can apply substituted compliance with respect to Exchange Act section 15F(g).

Fifth, the proposed Order included a condition that 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.[460] In response, commenters requested that the Commission provide a time period for furnishing such translations that is commensurate with the scope of the Commission's request.[461] Records requested by the Commission staff must be provided promptly. Requests for translations of those records may require additional time. The facts and circumstances of a particular requests (i.e., the volume of records requested and the extent to which they contain narrative text as opposed to figures) will implicate the timing of production. Therefore, the Commission does not believe it would be appropriate to prescribe a timeframe for production. The Commission is adopting the English translation requirement in paragraph (f)(7) of the final Order as proposed.

Sixth, the Commission conditioned substituted compliance with Exchange Act rule 18a-7 on Covered Entities filing periodic unaudited financial and operational information with the Commission or its designee in the manner and format required by Commission rule or order. Commenters made suggestions about the scope and requirements of such a Commission order or rule in addition to reiterating comments previously made in response to the same condition in the German order.[462] First, if SBS Entities are required to prepare FOCUS Report Part II, and a positive substituted compliance determination is made with respect to the Commission's capital requirements, a commenter proposed that the Commission permit an SBS Entity to submit capital computations in a manner consistent with its home country capital standards and related

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460 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85734 (discussing this condition).

461 See FBF Letter at 2; SIFMA Letter I at 14.

462 See SIFMA Letter I at 15; SIFMA Letter II at Appendix B.

reporting rules.[463] Second, some commenters asked that Covered Entities be permitted to file their unaudited financial information less frequently (e.g., quarterly) and provide a later submission deadline to match the frequency of reporting and reporting deadline required by the Covered Entity's home country regulator,[464] while other comment urged that Covered Entities be subject to monthly instead of quarterly reporting of their financial condition.[465] Third, commenters supported a potential approach identified by the Commission under which Covered Entities would be permitted to satisfy their Exchange Act rule 18a-7 obligations for a two-year period by filing the FOCUS Report Part IIC with only a limited number of the required line items completed.[466] Fourth, the Commission received comment recommending that the FOCUS Report be modified to omit certain line items either permanently or during a two-year transition.[467] The Commission will consider these comments as it works towards completing a Commission order or rule pursuant to the provision in this Order that substituted compliance with respect to Exchange Act rule 18a-7's FOCUS Report filing requirement is conditioned on Covered Entities filing unaudited financial and operational information in the manner and format specified by Commission order or rule. The Commission will consider these comments as it works towards completing a Commission order or rule pursuant to the provision in this Order that substituted compliance with respect to Exchange Act rule 18a-7's FOCUS Report filing requirement is conditioned on Covered Entities filing unaudited financial and operational information in the manner and format specified by Commission order or rule.

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463 See SIFMA Letter I at 15.; SIFMA Letter II at Appendix B. See also FBF Letter at 3 (supporting the SIFMA Letter I's observations and recommendations that would provide additional flexibility for SBS Entities with respect to their financial reporting obligations).

464 See SIFMA Letter I at 15-16; SIFMA Letter II at Appendix B. See also FBF Letter at 3 (supporting the SIFMA Letter I's observations and recommendations that would provide additional flexibility for SBS Entities with respect to their financial reporting obligations).

465 See AFR Letter at 1.

466 See SIFMA Letter I at 16; SIFMA Letter II at Appendix B; FBF Letter at 3.

467 See SIMA Letter II at Appendix B.

Seventh, the Commission's positive substituted compliance determination for Exchange Act rule 18a-7 identifies a number of conditions regarding the requirement to file annual audited reports pursuant to Exchange Act rule 18a-7. The third condition states SBS Entities that are not required under French or EU laws to file a report of an independent public accountant covering their financial statements must file such an accountant's report. In its proposal, the Commission requested comment on whether the independent public accountant must meet the Commission's independence standards for public accountants. The Commission did not receive comment on this point, but to ensure that the SBS Entity's accountant is subject to independence standards, the Commission is adding to the third condition the requirement that the SBS Entity's accountant complies with French independence requirements.[468]

Eighth, in its proposal, the Commission requested comment on whether there are any French SBS Entities that are not expected to be exempt from Exchange Act rule 18a-4, and therefore should be required to file certain supporting schedules under Exchange Act rule 18a-7 that relate to Exchange Act rule 18a-4. The Commission did not receive comment on this point, but in case such entities exist, paragraph (f)(3)(E) of the Order now includes a condition requiring SBS Entities to file with the Commission the supporting schedules required by Exchange Act rule 18a-7(c)(2)(ii) and (iii) that relate to Exchange Act rule 18a-4 (i.e., Computation for Determination of Security-Based Swap Customer Reserve Requirements and Information Relating to the Possession or Control Requirements for Security-Based Swap Customers) if the SBS Entity is not exempt from Exchange Act 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.

The Commission also received comment suggesting certain modifications to the ordering language. Specifically, a commenter suggested revising paragraph (f)(4) of the French

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468 See para. (f)(3)(iii)(C) of the Order.

Substituted Compliance Notice and Proposed Order, which requires a Covered Entity to send a copy of any notice required to be sent by EU and French laws cited in paragraph (f)(4) simultaneously to the Commission. The commenter recommended revising this provision to require the notices that a Covered Entity would be required to send to the Commission be limited to those notices required by EU and French law that are comparable to Exchange Act rule 18a-8(d) instead of the entirety of Exchange Act rule 18a-8. Furthermore, the commenter recommended conditioning the requirement to provide these notices to the Commission to be limited to those notifications that are related to (1) a breach of the EU and French laws cited in the relevant portions of paragraphs (f)(1) or (2) of the Order, which, in the case of a Covered Entity that is prudentially regulated, also relates to the Covered Entity's business as a security-based swap dealer or major security-based swap participant, or (2) a deficiency relating to capital requirements.[469] The commenter reasoned that the provisions of EU and French law requiring notification contained in paragraph (f)(4) require notification of a far wider array of matters than those described in Exchange Act rule 18a-8. The Commission disagrees. Exchange Act rule 18a-8 requires security-based swap dealers and major security-based swap participants for which there is no prudential regulator to notify the Commission of a failure to meet minimum net capital. Exchange Act rule 18a-8 also specifies several events that trigger a requirements that a security-based swap dealer or major security-based swap participant for which there is no prudential regulator must sent notice within twenty-four hours to the Commission. These notices are designed to provide the Commission with "early warning" that the SBS entity may experience financial difficulty. Furthermore, Exchange Act rule 18a-8 requires bank security-based swap dealers to give notice to the Commission when it files an adjustment of its reported capital category with its prudential regulator. Additional notification requirements arise with respect to the failure to maintain and keep current required books and records, the discovery of

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469 See SIFMA Letter II at Appendix A.

material weaknesses, and failure to make a required deposit into the special reserve account for the exclusive benefit of security-bases swap customers.[470] While the specific EU and French requirements cited with respect to Exchange Act rule 18a-8 are different from the specific requirements set forth in Exchange Act rule 18a-8, the Commission believes the EU and French notice requirements cited in paragraph (f)(4) of the Order provide for comparable regulatory outcomes by requiring notification of events or conditions which may impact an SBS Entity's capital or signal the potential for financial difficulty, indicate the failure to maintain and keep current books and records, or the potential for the failure to comply with other requirements related to the protection of customer assets. The recommended revisions would reduce the scope of notifications the Commission would receive. Consequently, the Commission is not making the recommended revisions with respect to paragraph (f)(4).

The commenter also recommended revising paragraphs (f)(2)(i)(H)(*1*), (f)(3)(i)(A), and (f)(3)(ii)(A) to include the qualifier "as applicable" with respect to citations to CRR Reporting ITS annexes. The commenter stated that not all firms submit all of the CRR Reporting ITS annexes.[471] Accordingly, the Commission is modifying these paragraphs to include the qualifier "as applicable."[472]

2. Citations to EU and French Law

The Commission also received comment recommending changes to the French Substituted Compliance Notice and Proposed Order to refine the scope of French law provisions that would operate as conditions to substituted compliance.[473] The Commission reviewed each of the EU or French law citations that the commenter recommended adding or removing from the Order for relevance to the comparable Exchange Act requirement while also keeping in mind

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470 See Exchange Act rule 18a-8, 17 CFR 240.18a-8.

471 See SIFMA Letter II at Appendix A.

472 See paras. (f)(2)(i)(H)(*1*), (f)(3)(i)(A), and (f)(3)(ii)(A) of the Order.

473 See SIFMA Letter II at Appendix A. See also SIFMA Letter I at 4-7; FBF Letter at 2-3.

that each EU or French law citation was included in the French Authorities' Application intentionally. The Commission's conclusion and reasoning with respect to the commenter's recommendations is discussed in further detail below. In addition to refining the scope of EU and French law citations in response to comment, the Order reflects changes to the EU and French law citations after cite checking the EU and French law provisions in the French Substituted Compliance Notice and Proposed Order against the EU and French law provisions cited in the French Authorities' Application, as well as the UK implementation of the EU law provisions cited in the UK Proposed Order Granting Substituted Compliance in Connection with Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the French Republic.

a. Global

The commenter recommended deleting references to MiFID Org Reg, reasoning that these provisions could raise issues due to the discrepancy between Exchange Act requirements, which apply on an entity-level basis, and these EU requirements, which are territorially limited. As explained in part III.C. above, conducting business outside France does not preclude a firm from relying on substituted compliance for the business it conducts within France. Accordingly, unless specified otherwise below, the Commission is not removing references to these EU and French law requirements from the Order's list of EU and French law requirements comparable to the Commission's recordkeeping, reporting, notification, and securities count requirements.

The commenter recommended deleting references to MiFID article 25(2) and MLD articles 11 and 13 and their French implementing provisions, which relate to customer information and suitability requirements, reasoning that these provisions do not correspond to, and go beyond, the Commission's recordkeeping, reporting, notification, and securities count requirements. The Commission agrees with the commenter's reasoning, except with respect to Exchange Act rule 18a-5(a)(7) and (b)(7) (customer account records), Exchange Act rule 18a-5(a)(17) and (b)(13) (suitability record creation), and Exchange Act rule 18a-6 (b)(1)(xii)

(suitability record preservation). Therefore, the Commission is removing references to these requirements from the Order's list of EU and French law requirements comparable to the Commission's recordkeeping, reporting, notification, and securities count requirements, except for Exchange Act rules 18a-5(a)(7), (a)(17), (b)(7), and (b)(13).[474]

The commenter recommended deleting references to MiFID Org Reg article 76, MiFID article 16(7) and its French implementing provisions, and MFC article L. 533-10 III, which relate to the recording of telephone and electronic communications, reasoning that they do not correspond to, and go beyond, the requirements of the Commission's recordkeeping, reporting, notification, and securities count rules. The Commission agrees with the commenter's reasoning, except with respect to Exchange Act rules 18a-6(b)(1)(iv) and (b)(2)(ii), which relate to communications including telephonic communications. Therefore, the Commission is removing references to these requirements from the Order's list of EU and French law requirements comparable to the Commission's recordkeeping, reporting, notification, and securities count requirements, except for Exchange Act rules 18a-6(b)(1)(iv) and (b)(2)(ii).[475]

The commenter recommended deleting references to the EBA Guidelines on Outsourcing, reasoning that they only contain nonbinding guidance. The Commission agrees with the commenter's reasoning and is therefore removing references to this requirement from the Order's list of EU and French law requirements comparable to the Commission's recordkeeping, reporting, notification, and securities count requirements.[476]

b. Exchange Act rules 18a-5 and 18a-6

The commenter recommended deleting references to MiFIR article 25(1), which sets a duration of five years for firms to keep relevant data relating to orders and transactions in

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474 See paras. (f)(1)(i)(D)(*1*), (f)(1)(i)(G)(*1*), (f)(1)(i)(I)(*1*), (f)(2)(i)(A), (f)(2)(i)(B), and (f)(2)(i)(D) of the Order.

475 See paras. (f)(1)(i)(A)(*1*), (f)(1)(i)(D)(*1*), (f)(1)(i)(F)(*1*), (f)(1)(i)(G)(*1*), (f)(1)(i)(I)(*1*), (f)(1)(i)(M), (f)(2)(i)(A), (f)(2)(i)(B), and (f)(2)(i)(O)(*1*) of the Order.

476 See para. (f)(2)(i)(R) of the Order.

financial instruments, reasoning that this does not correspond to, and goes beyond, the requirements of Exchange Act rules 18a-5 and 18a-6. With respect to Exchange Act rule 18a-6, the five year record retention period is directly relevant to the record preservation requirement in Exchange Act rule 18a-6. With respect to Exchange Act rule 18a-5, while this requirement contains a record retention element, it also contains a record creation requirement that is relevant to Exchange Act rule 18a-5. Accordingly, the Commission is not removing references to this requirement from the Order's list of EU and French law requirements comparable to Exchange Act rules 18a-5 and 18a-6.

The commenter recommended deleting references to CRD article 73 and its French implementing provisions, reasoning that it relates to substantive capital requirements. CRD article 73 requires firms to "have in place sound, effective and comprehensive strategies and processes to assess and maintain…internal capital" which the French Authorities' Application states in practice will require "the maintenance of full records of the Investment Firm's assets, liabilities, income and expense and capital accounts to be maintained on an on-going basis."[477] Accordingly, the Commission is not removing references to this requirement from the Order's list of EU and French law requirements comparable to Exchange Act rules 18a-5 and 18a-6.

The commenter recommended deleting references to MiFID Delegated Directive article 2 and its French implementing provisions, reasoning that they do not relate to recordkeeping. The Commission disagrees because MiFID Delegated Directive article 2 requires, among other things, that firms "keep records and accounts enabling them…to distinguish assets held for one client from assets held for any other client and from its other own assets" which directly implicates record creation and preservation. Accordingly, the Commission is not removing references to these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rules 18a-5 and 18a-6.

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[477] See French Authorities' Application Annex I category 2 at 14.

The commenter recommended deleting references to EMIR article 11, which relates to timely confirmation of transactions, and EMIR article 39, which relates to a firm's requirement to segregate the positions they clear for a client with a central counterparty from their own positions, reasoning that they do not correspond to, and go beyond, the requirements of Exchange Act rules 18a-5 and 18a-6. While these requirements contain segregation and confirmation requirements, they also contain record creation requirements that are relevant to Exchange Act rule 18a-5. Accordingly, the Commission is not removing references to these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-5, except with respect to Exchange Act rule 18a-5(a)(12) for which the Commission agrees with the commenter's reasoning.[478] However, the Commission agrees these provisions do not relate to record preservation is removing references to these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-6.[479]

The commenter recommended deleting references to MiFID articles 25(5) and 25(6) and their French implementing provisions, reasoning that they do not correspond to, and go beyond, the requirements of Exchange Act rules 18a-5 and 18a-6. Both provisions contain record creation elements, because MiFID article 25(5) requires firms to "establish a record" setting out the rights and obligations of the firm and the client, and MiFID article 25(6) requires firms to prepare client reports "in a durable medium." Accordingly, the Commission is not removing references to these requirement from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-5. However, the Commission agrees that these provisions do not relate to record preservation and is removing references to these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-6,[480]

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478 See para. (f)(1)(i)(L)(*1*) of the Order.

479 See paras. (f)(2)(i)(A), (f)(2)(i)(B), (f)(2)(i)(D), (f)(2)(i)(F)(*1*), (f)(2)(i)(G)(*1*), and (f)(2)(i)(Q) of the Order.

480 See para. (f)(2)(i)(P)(*1*) of the Order.

except with respect to Exchange Act rule 18a-6(d)(4) and (d)(5) which implicates record creation in addition to record preservation.[481]

The commenter recommended deleting references to CRR articles 103, 105(3), and 105(10), which relate to the firm's management of trading book exposures, reasoning that they do not correspond to, and go beyond, the requirements of Exchange Act rules 18a-5 and 18a-6. However, the French Authorities' Application states that these requirements in practice require firms to have "a record of their long and short positions to enable these to be monitored" which is relevant to Exchange Act rules 18a-5 and 18a-6.[482] Accordingly, the Commission is not removing references to these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rules 18a-5 and 18a-6.

The commenter recommended deleting references to MiFID article 16(6) and its French implementing provisions, reasoning that they do not correspond to, and go beyond, the requirements of Exchange Act rules 18a-5 and 18a-6. MiFID article 16(6) requires firms to "arrange for records to be kept of all services, activities and transactions undertaken by it" which is relevant to record creation and preservation. Accordingly, the Commission is not removing references to these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rules 18a-5 and 18a-6.

The commenter recommended deleting references to CRR article 104(1)(j) from the Order, reasoning that the provision does not exist. The Commission confirmed with the French Authorities that references to CRR article 104(1)(j) were intended to reference CRD article 104(1)(j). However, CRD article 104(1)(j) relates to supervisory power of authorities to impose additional reporting requirements which the Commission believes does not correspond to, and

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481 See paras. (f)(2)(i)(A), (f)(2)(i)(B), (f)(2)(i)(C)(*1*), (f)(2)(i)(D), (f)(2)(i)(G)(*1*), (f)(2)(i)(I)(*1*), and (f)(2)(i)(O)(*1*) of the Order.

482 See French Authorities' Application Annex 1 category 2 at 16.

goes beyond the requirements of Exchange Act rule 18a-6. Therefore, references in the Order to CRD article 104(1)(j) and its French implementing provisions are not included.[483]

The commenter recommended deleting references to MiFID Org Reg article 59, which sets out the requirement to confirm execution of an order to the client, reasoning that it does not correspond to, and goes beyond, the requirements of Exchange Act rules 18a-5 and 18a-6. MiFID Org Reg article 59 identifies specific data elements that are relevant to the records required to be created under Exchange Act rule 18a-5, so the Commission is not removing references to this requirement from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-5. However, the Commission believes that MiFID Org Reg article 59 relates to record creation but not record preservation and is therefore removing references to this requirement from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-6.[484]

The commenter recommended adding to paragraphs (f)(1) and (f)(2) of the Order references to Internal Control Order articles 85, 86, 92, and 93, which impose audit trail requirements. The Commission agrees these requirements are relevant because they relate to record creation and preservation, and is therefore adding them to the Order's list of EU and French requirements comparable to Exchange Act rules 18a-5 and 18a-6.[485]

The commenter recommended deleting from paragraphs (f)(2)(i)(A) and (f)(2)(i)(B) of the Order references to MiFID article 69(2) and its French implementing provisions, because these provisions relate to the powers of the competent authorities rather than the obligations of the entity. The Commission disagrees, because a regulator can only "have access to any document or data…relevant for the performance of its duties" as required by MiFID article 69(2)

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483 See paras. (f)(2)(i)(E)(*1*) and (f)(2)(i)(H)(*1*) of the Order.

484 See paras. (f)(2)(i)(A), (f)(2)(i)(B), (f)(2)(i)(D), and (f)(2)(i)(G)(*1*) of the Order.

485 See paras. (f)(1)(i)(A)(*1*), (f)(1)(i)(B)(*1*), (f)(1)(i)(D)(*1*), (f)(1)(i)(F)(*1*), (f)(1)(i)(G)(*1*), (f)(1)(i)(H)(*1*), (f)(1)(i)(I)(*1*), (f)(1)(i)(K), (f)(1)(i)(N)(*1*), (f)(1)(i)(O)(*1*), (f)(2)(i)(C)(*1*), (f)(2)(i)(D), (f)(2)(i)(E)(*1*), and (f)(2)(i)(H)(*1*) of the Order.

if firms are required to preserve these documents and data. Accordingly, the Commission is not removing references to these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-6(a)(1), (a)(2), (b)(1)(i), and (b)(2)(i).

The commenter recommended adding to paragraphs (f)(2)(I)(*1*) and (f)(2)(J)(*1*) of the Order references to Internal Control Order articles 94 through 96 and 99 through 102, which require firms to implement risk analysis, measurement and management systems. The Commission agrees these requirements are relevant because these systems in practice will require preservation of risk management and counterparty credit risk records, and is therefore adding them to the Order's list of EU and French requirements comparable to Exchange Act rules 18a-6(b)(1)(ix) and (b)(1)(x).[486]

The commenter recommended replacing in paragraph (f)(1)(i)(K) of the Order references to MiFID Org Reg article 21(1)(a) with references to MiFID Org Reg article 21(1)(d) due to an incorrect reference in the French Authorities' Application with respect to Exchange Act rule 18a-5(a)(10) and (b)(8). The Commission agrees with the commenter's reasoning and is therefore replacing references to MiFID Org Reg article 21(1)(a) with references to MiFID Org Reg article 21(1)(d) in the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-5(a)(10) and (b)(8).[487]

The commenter recommended replacing in paragraphs (f)(1)(i)(N)(*1*) and (f)(1)(i)(O)(*1*) of the Order references to EMIR RTS article 15(1) with EMIR RTS article 15(1)(a) with respect to Exchange Act rule 18a-5(a)(18) and (b)(14) because the remainder of article 15(1) does not include a record creation requirement. The Commission agrees with the commenter's reasoning and is therefore replacing references to EMIR RTS article 15(1) with EMIR RTS article 15(1)(a) in the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-5(a)(18) and (b)(14).

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486 See paras. (f)(2)(i)(I)(*1*) and (f)(2)(i)(J)(*1*) of the Order.

487 See para. (f)(1)(i)(K) of the Order.

The commenter recommended deleting from paragraph (f)(2)(E)(*1*) of the Order references to CRR and CRR Reporting ITS, which relate to supervisory reports to be made, reasoning that they do not correspond to, and go beyond, the requirements of Exchange Act rule 18a-6(b)(1)(v). Although these laws relate to reporting requirements, the information required to be included in these reports is relevant to the records required by Exchange Act rule 18a-6(b)(1)(v). In addition, the French Authorities' Application specifically cites these requirements as comparable to Exchange Act rule 18a-6(b)(1)(v).[488] Accordingly, the Commission is not removing references to this requirement from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-6(b)(1)(v).

The commenter recommended adding to paragraphs (f)(2)(i)(F) and (f)(2)(i)(K)(*1*) of the Order a reference to MFC article L. 561-12 with respect to Exchange Act rules 18a-6(b)(1)(vi) and (b)(2)(iii) (records of discretionary authority for security-based swap accounts) and (b)(1)(xii) and (b)(2)(vii) (business conduct records). The Commission agrees this provision is relevant because it requires firms to keep documents relating to business relationships and customers for 5 years after an account is closed. Therefore, the Commission is adding MFC article L. 561-12 to the Order's list of EU and French requirements comparable to Exchange Act rules 18a-6(b)(1)(vi), (b)(1)(xii), (b)(2)(iii), and (b)(2)(vii).[489]

The commenter recommended deleting from paragraph (f)(2)(i)(I)(*1*) of the Order references to CRR articles 286 and 293(1)(d), which relate to the use of internal models for credit risk, reasoning that they do not correspond to, and go beyond, the requirements of Exchange Act rule 18a-6(b)(1)(ix). The "policies, processes and systems" (with respect to CRR article 286) and "adequate resources [] devoted to credit and counterparty risk control" (with respect to CRR article 293(1)(d)) in practice require firms to maintain records relevant to Exchange Act rule 18a-6(b)(1)(ix). Accordingly, the Commission is not removing references to

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488 See French Authorities' Application Annex I category 2 at 51-52.

489 See paras. (f)(2)(i)(F) and (f)(2)(i)(K)(*1*) of the Order.

these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-6(b)(1)(ix).

The commenter recommended deleting from paragraph (f)(2)(i)(I)(*1*) of the Order references to EMIR RTS, reasoning that referencing an entire law without referencing a specific provision does not correspond to, and goes beyond, the requirements of Exchange Act rule 18a-6(b)(1)(ix). This provision is cited by the French Authorities' Application as directly relevant because it requires firms to have "formalised processes" "to measure, monitor and mitigate operational risk and counterparty credit risk,"[490] which is relevant to Exchange Act rule 18a-6(b)(1)(ix). Accordingly, the Commission is not removing references to this requirement from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-6(b)(1)(ix).

The commenter recommended removing from paragraph (f)(2)(i)(I)(*1*) of the Order the reference to CRD articles 75 through 87 and their French implementing provisions, reasoning that these provisions cover various capital matters that do not correspond to, and go beyond, the requirements of Exchange Act rule 18a-6(b)(1)(ix). The Commission disagrees, because these provisions are cited in the French Authorities' Application as directly relevant due to the "risk management arrangements, policies and procedures required to be implemented" under these provisions.[491] Accordingly, the Commission is not removing references to these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-6(b)(1)(ix).

The commenter recommended deleting from paragraphs (f)(1)(i)(K) and (f)(2)(i)(M) of the Order (employment application record creation and preservation) references to MiFID articles 9(1) and 16(3) and their French implementing provisions, reasoning that these provisions do not relate to recordkeeping. Both provisions require recordkeeping in practice through their

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490 See French Authorities' Application Annex I category 2 at 60.

491 See French Authorities' Application Annex I category 2 at 58-59.

requirements to monitor conflicts of interest. Accordingly, the Commission is not removing references to these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-5(a)(10) and (b)(8) and Exchange Act rule 18a-6(d)(1).

The commenter recommended adding to paragraphs (f)(2)(i)(L) and (f)(2)(i)(O) of the Order the reference to MiFID Org Reg article 21(1)(f) with respect to Exchange Act rules 18a-6(c) (organizational records) and (d)(3) (compliance records). The Commission agrees this provision is relevant because it requires firms to "maintain adequate and orderly records of their business and internal organization." Therefore, the Commission is adding MiFID Org Reg article 21(1)(f) of the Order's list of EU and French requirements comparable to Exchange Act rule 18a-6(c) and (d)(3).[492]

c. Exchange Act rule 18a-7

The commenter recommended deleting from paragraphs (f)(3)(i)(A) and (f)(3)(ii)(A) references to CRD article 104(1)(j) relating to supervisory power of authorities to impose additional reporting requirements, reasoning that this provision does not correspond to, and goes beyond the requirements of Exchange Act rule 18a-7(a)(1) and (a)(2), and (a)(3). The Commission agrees. Accordingly, the Commission is removing references to these requirements and references to related implementing regulations MFC article L. 612-24 and Decree of 20 February 2007 relating to prudential requirements article 6 from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-7(a)(1) and (a)(2).[493]

The commenter recommended deleting from paragraph (f)(3)(ii)(A) references to CRR articles 431 through 455 relating to public disclosures, reasoning that such provisions do not relate to regulatory reporting. However, the French Authorities' Application cites CRR articles 431, 433, 452, 454, and 455 as requiring, among other things, firms to make "Pillar III' disclosures which include information on the use of capital models and matters such as credit

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492 See paras. (f)(2)(i)(L) and (f)(2)(i)(O)(*1*) of the Order.

493 See paras. (f)(3)(i)(A) and (f)(3)(ii)(A) of the Order.

risk, the exposure values by class of exposures subject to evaluation using models, and internal controls on the development and use of models.[494] This information is relevant to Rule 18a-7(a)(3) and 18a-7(j). Accordingly, the Commission is removing references to CRR articles 431 through 455 except for CRR articles 431, 433, 452, 454, and 455 in the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-7(a)(3) and 18a-7(j).[495]

The commenter recommended deleting from paragraph (f)(3)(ii)(A) references to Accounting Directive article 34, French Commerce Code articles L. 232-1, R. 232-1 through R. 232-8, and L. 823-1 through L. 823-8-1, relating to general publication requirements for financial statements, and to the appointment of external financial auditors. The commenter reasoned that these provisions do not correspond to, and go beyond, the requirements of Exchange Act rule 18a-7(a)(3) and 18a-7(j). The Commission agrees. Accordingly, the Commission is removing references to these EU and French law requirements in the Order's list of requirements comparable to Exchange Act rule 18a-7(a)(3) and 18a-7(j).[496]

The commenter recommended deleting from paragraph (f)(3)(iii) references to CRR articles 435-436, 441, 444, and 450 (stating that these provisions are not in the UK Proposed Order), as well as Accounting Directive article 34, and French Commerce Code articles L. 232-1, R. 232-1 through R. 232-8, L. 823-1 through L. 823-8-1. The commenter reasoned that these provisions do not correspond to, and go beyond, the requirement requirements of Exchange Act rule 18a-7(b). The Commission disagrees. The French Authorities' Application states that pursuant to CRR articles 431 to 455, CRR firms are required to make "Pillar III" public disclosures at least annually in connection with the publication, and that such disclosures cover a variety of matters including, among other things, capital resources and capital requirements. Furthermore, in referencing CRR articles 431 to 455, the French Authorities' Application states

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494 See French Authorities' Application Annex I Category 2 at 91-93.

495 See para. (f)(3)(ii)(A) of the Order.

496 See para. (f)(3)(ii)(A) of the Order.

that the requirements are comparable to analogous requirements under relevant provisions of Exchange Act rule 18a-7(b).[497] Accordingly, the references to these EU and French law requirements, and is instead including references to CRR articles 431 to 455 in the Order's list of requirements comparable to Exchange Act rule 18a-7(b).[498] With respect to Accounting Directive article 34, and French Commerce Code articles L. 232-1, R. 232-1 through R. 232-8, L. 823-1 through L .823-8-1, the Commission agrees with the commenter regarding references to Accounting Directive article 34, but disagrees with respect to the references to French Commerce Code L. 232-1, R. 232-1 through R. 232-8, L. 823-1 through L. 823-8-1. The French Authorities' Application states that credit institutions and investment firms must have their financial statements audited, and must publish their financial statements and management report annually pursuant to Accounting Directive articles 30 and 34. These requirements are relevant to Exchange Act rule 18a-7(b). Accordingly, the Commission is deleting references to Accounting Directive article 34, but is not deleting reference to French Commerce Code L. 232-1, R. 232-1 through R. 232-8, L. 823-1 through L. 823-8-1 in the Order's list of requirements comparable to Exchange Act rule 18a-7(b).[499]

The commenter recommended deleting references in paragraph (f)(3)(iv)(A) references to MiFID Org Reg article 72(2) and Annex I, which relate to recordkeeping requirements. The Commission notes that MiFID Org Reg article 72(2) and Annex I are not cited in connection with the EU and French law requirements in the Order's list of requirements comparable to Exchange Act rule 18a-7(b). The commenter also recommended deleting reference to CRR and CRD articles which set out specific capital requirements. With respect to CRD article 89, the Commission agrees as this provision requires member states to impose specified disclosure requirements on institutions. Accordingly, the Commission is deleting reference to this

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497 See French Authorities' Application Annex I at 93-94.

498 See para. (f)(3)(iii) of the Order.

499 See para. (f)(3)(iii) of the Order.

requirement in the Order's list of requirements comparable to Exchange Act rule 18a-7(c) through (h).[500] With respect to the cited CRR provisions, the Commission disagrees. The French Authorities' Application states that CRR article 26(2) relates to the inclusion of a firm's interim or year-end profits in Common Equity Tier 1 capital and the associated requirement that such profits be verified by persons independent of the firm, and that CRR articles 132(5) and 154 set forth requirements for a firm to engage an external auditor to confirm the accuracy of information regarding the firm's calculations with respect to average risk weights for certain exposures which is comparable to the requirements under Exchange Act rules 18a-7(c)(1)(i)(C) and 18a-7(d) through (g). Furthermore the French Authorities' Application states that, for firms using internal models to calculate credit risk, operational risk, market risk exposures, or market risk capital requirement, CRR articles 191, 321, 325bi, and 368 require various levels of internal or external audit and/or review of the models, systems, and/or operations. The French Authorities' application notes where investment firm's rely on a depository or management company of a collective investment undertaking, CRR articles 418, 350 and 353 require the investment firm to calculate and report own funds requirements for the market value of haircuts, and position risk with respect to positions in specified instruments.[501] As a result, the French Authorities' Application states that the EU report review requirements provide for comparable regulatory outcomes to the SEC report review requirements, as both regulatory regimes require firms to submit reports by independent auditors on the firm's financial and operational information in order to ensure the accuracy of information and protect market participants. The Commission believes these provisions are relevant to Rule 18a-7(c), (d), (e), (f), (g), and (h). Accordingly, the Commission is not deleting references to these EU and French law in the Order's list of requirements comparable to Exchange Act rule 18a-7(c) through (h).[502]

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500 See para. (f)(3)(iv)(A) of the Order.

501 See French Authorities' Application Annex I categories 2 and 4 at 99-102.

502 See para. (f)(3)(iv)(A).

The commenter recommended deleting references to Accounting Directive article 34 from paragraph (f)(3)(iv)(A), stating that this provision sets out accounting and publication requirements applicable to corporations generally, and is not enforced by the ACPR or the AMF, and reasons that the provision does not correspond to, and goes beyond, the requirements of Exchange Act rule 18a-7 (c) through (h). The commenter suggests replacing this provision instead with MFC articles L. 511-35 to L. 511-38, setting forth accounting and publication obligations for credit institutions, and article L. 533-5 which sets forth accounting and publication obligations for investment firms. With respect to Accounting Directive article 34, the Commission agrees. As a result, the Commission is deleting reference to Accounting Directive article 34 from the Order's list of requirements comparable to Exchange Act rule 18a-7(c) through (h).[503] With respect to the commenter's recommendation regarding MFC articles L. 511-35 to L. 511-38, and article L. 533-5, the Commission agrees and, accordingly, is including references to these provisions in the Order's list of requirements comparable to Exchange Act rule 18a-7(c) through (h).[504]

The commenter recommended deleting references in paragraph (f)(3)(iv)(A) to MiFID articles 16(8) through (10). The commenter reasoned that these provisions contain substantive, not reporting requirements, and do not correspond to, and go beyond, the requirements of Exchange Act rules 18a-7(c) through (h). The Commission agrees and is not including references to these provisions in the Order's list of requirements comparable to Exchange Act rules 18a-7(c) through (h).[505]

d. Exchange Act Rule 18a-8

The commenter recommended deleting references MiFID article 73, and CRD article 71 (as well as the implementing provisions) from paragraphs (f)(4)(i)(A)(*1*), (f)(4)(i)(B),

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503 See para. (f)(3)(iv)(A) of the Order.

504 See para. (f)(3)(iv)(A) of the Order.

505 See para. (f)(3)(iv)(A) of the Order.

(f)(4)(i)(C)(*1*), and (f)(4)(i)(D)(*1*), reasoning that these provisions do not correspond to, and go beyond, the requirements of Exchange Act Rule 18a-8(a)(1)(i), (a)(1)(ii), (b)(1), (b)(2), (b)(4), (c), (d), (e), and (h). The Commission agrees with respect to references to MiFID article 73 and CRD article 71, but disagrees with respect to the implementing provisions. The French Authorities' Application cite the implementing provisions as providing for comparable regulation outcomes to the Commission's notice requirements as both regimes aim to establish reporting mechanisms so that regulators will be promptly notified of relevant events. The Commission believes the implementing provisions, MFC articles L. 511-33II, L. 634-1, and L. 634-2, are relevant to the requirements of Exchange Act Rule 18a-8(a)(1)(i), (a)(1)(ii), (b)(1), (b)(2), (b)(4), (c), (d), (e), and (h). Accordingly, the Commission is deleting references to MiFID article 73 and CRD article 71, but is not deleting references to the implementing regulations MFC articles L. 511-33II, L. 634-1, and L. 634-2, from the Order's list of requirements comparable to Exchange Act rule 18a-8(a)(1)(i), (a)(1)(ii), (b)(1), (b)(2), (b)(4), (c), (d), (e), and (h).[506]

The commenter recommended including references to Internal Control Order 249 and 249-1 in paragraphs (f)(4)(i)(A)(*1*), (f)(4)(i)(B), (f)(4)(i)(C)(*1*), and (f)(4)(i)(D)(*1*). The Commission agrees. Accordingly, the Commission is adding references to Internal Control Order 249 and 249-1 to the Order's list of requirements comparable to Exchange Act rule 18a-8(a)(1)(i), (a)(1)(ii), (b)(1), (b)(2), (b)(4), (c), (d), (e), and (h).[507]

e. Exchange Act Rule 18a-9

The commenter recommended deleting references to MiFID Org Reg articles 74 and 75, from paragraph (f)(5)(*1*), reasoning that these provisions relate to recordkeeping requirements and therefore go beyond the requirements of Exchange Act rule 18a-9. The Commission agrees.

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506 See paras. (f)(4)(i)(A)(*1*), (f)(4)(i)(B), (f)(4)(i)(C)(*1*), and (f)(4)(i)(D)(*1*) of the Order.

507 See paras. (f)(4)(i)(A)(*1*), (f)(4)(i)(B), (f)(4)(i)(C)(*1*), and (f)(4)(i)(D)(*1*) of the Order.

Accordingly, the Commission is removing references to these requirements from the Order's list of EU and French law requirements comparable to Exchange Act rule 18a-9.[508]

f. Exchange Act Section 15F(g)

The commenter recommended including references to MiFID Org Reg articles 21(1)(f), 21(4), and 72(1) in paragraph (f)(6). The Commission agrees. These provisions require investment firms to maintain adequate and orderly business and internal organization records, have policies and procedures in place enabling them to deliver to a competent authority in a timely manner financial reports reflecting a true and fair view of the investment firm's financial position, and retain specified records. The Commission believes that these provisions are relevant to the requirements of Exchange Act section 15F(g). Accordingly, the Commission is adding citations to these provisions in the Order's list of requirements comparable to Exchange Act section 15F(g).

IX. Supervisory and Enforcement Considerations

A. Proposed approach

Exchange Act rule 3a71-6(a)(2)(i) provides that the Commission's assessments regarding the comparability of foreign requirements in part should take into account "the effectiveness of the supervisory program administered, and the enforcement authority exercised" by the foreign financial regulatory authority. This provision is intended to help ensure that substituted compliance is not predicated on rules that appear high-quality on paper if market participants in practice are allowed to fall short of their obligations, while also recognizing that differences among supervisory and enforcement regimes should not be assumed to reflect flaws in one regime or another.[509] The French Authorities' Application accordingly included information regarding the supervisory and enforcement framework applicable to derivatives markets and market participants in France.

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508 See para. (f)(5)(*1*) of the Order.

509 See French Substituted Compliance Notice and Proposed Order, 85 FR at 85734.

In proposing to grant substituted compliance in connection with the French Authorities' Application, the Commission preliminarily concluded that the relevant supervisory and enforcement considerations were consistent with substituted compliance. That preliminary conclusion took into account information regarding the French Authorities' and the ECB's roles and practices in supervising investment firms and credit institutions located in France, as well as their enforcement-related authority and practices.[510]

B. Commenter views and final provisions

Commenters did not address the Commission's preliminary conclusions regarding supervisory and enforcement considerations, and the Commission continues to conclude that the relevant supervisory and enforcement considerations in France are consistent with substituted compliance. In particular, based on the available information regarding the French Authorities' and the ECB's authority and practices to oversee market participants' compliance with applicable requirements and to take action in the event of violations, the Commission remains of the view that, consistent with rule 3a71-6, comparability determinations reflect French and EU requirements as they apply in practice.

To be clear, the supervisory and enforcement considerations addressed by rule 3a71-6 do not mandate that the Commission make judgments regarding the comparative merits of U.S. and foreign supervisory and enforcement frameworks, or to require specific findings regarding the supervisory and enforcement effectiveness of a foreign regime. The rule 3a71-6 considerations regarding supervisory and enforcement effectiveness instead address whether comparability analyses related to substituted compliance reflect requirements that market participants must follow, and for which market participants are subject to enforcement consequences in the event of violations. Those considerations are satisfied here.

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[510] Id. at 85734-36.

X. Conclusion

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 French Republic 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 MFC that implement MiFID and/or other EU and French 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 MFC L. 321-1, and fall within the scope of the Covered Entity's authorization from the AMF or from the ACPR after approval by the AMF of the Covered Firm's program of operations to provide investment services and/or perform investment activities in the French Republic.

(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 MFC that implement MiFID and/or other EU and French 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 as used in the relevant provision of MFC.

(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 MFC that implement MiFID and/or other EU and French 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 MFC L. 211-1 and D. 211-1A.

(4) Covered Entity as CRD/CRR "institution." For each condition in paragraph (b) through (f) of this Order that requires the application of, and the Covered Entity's compliance with, the provisions of CRD, provisions of MFC that implement CRD, CRR and/or other EU and French requirements adopted pursuant to those provisions, the Covered Entity is an "institution," as defined in CRD article 3(1)(3) and CRR article 4(1)(3), and is either a credit institution or finance company, each as defined in MFC L. 511-1.

(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 through 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 the French Authorities. The Commission and the AMF and the ACPR 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 French 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, the AMF or the ACPR 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 the AMF or the ACPR.

(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; MFC L. 533-2, L. 533-10.II and III, L. 533-24 and L. 533-24-1; MiFID Org Reg articles 21 through 37, 72 through 76 and Annex IV; CRD articles 74, 76, 79 through 87, 88(1), 91(1) and (2), 91(7) through (9), 92, 94 and 95; MFC L. 511-41-1-B and L. 511-41-1-C, L. 511-51, L. 511-52.I, L. 511-53, L.

511-55 through L. 511-69, L. 511-71 through 85, L. 511-89 through L. 511-97, L. 511-102, R. 511-18-2 and R. 511-16-3; Internal Control Order articles 106, 111, 114-15, 121-22, 130 through 134, 146 through 186, 211-12, 214-15; CRR articles 286 through 288 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(1); 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); MFC articles , 511-41-1 A, L. 511-41-1 B, L. 533-2-1, L. 533-2-2, L. 613-44, L. 613-49.I; Decree of 3 November 2014 on internal control, articles 10, 94-197, and 211-230; Decree of 3 November 2014 relating to capital buffers, articles 2, 16, 23, 56 through 62; and EMIR Margin RTS, articles 2, 3(b), 7, and 19(1)(d) and (e), (3), and (8);

(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:

(*1*) 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)(*1*);

(*b*) Compares the amount of the aggregate value the liquid assets maintained pursuant to paragraph (c)(1)(iii)(A)(*1*) 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)(*1*) 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)(*1*), 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); MFC articles L. 511-41-1-B, L. 533-2-2, L. 533-29, I al. 1, and L. 511-55 al. 1; and Decree of 3 November 2014 on internal control, article 114;

(ii) The Covered Entity collects variation 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) 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; MFC articles L. 533-2, L. 533-10.II and III, L. 533-24 and L. 533-24-1; MiFID Org Reg articles 21 through 37, 72 through 76 and Annex IV; CRD articles 74, 76, 79 through 87, 88(1), 91(1) and (2), 91(7) through (9), 92, 94 and 95; and MFC L. 511-41-1-B and L. 511-41-1-C, L. 511-51, L. 511-52.I, L. 511.53, L. 511-55 through L. 511-69, L. 511-71 through 85, L. 511-89 through L. 511-97, L. 511-102, R. 511-16-2 and R. 511-16-

3; Internal Control Order articles 106, 111, 114, 115, 121-22, 130-34, 146-86, 211-12, 214-15; 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); MFC L. 533-12.II and D. 533-15; 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 articles 23(2) and (3); MFC L. 533-10.II(3); and MiFID Org Reg articles 33 through 35;

(ii) MiFID article 24(9); MFC L. 533-12-4; MiFID Delegated Directive article 11(5); and AMF General Regulation article 314-17; 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); MFC L 533-10.II(2); MiFID Org Reg articles 21 and 22, 25 and 26 and applicable parts of Annex I; CRD articles 74(1) and 85(1); MFC L. 511-55 and L. 511-41-1-B; MLD articles 11 and 13; MFC L. 561-5, L. 561-5-1, L. 561-6, L. 561-10, L. 561-4-1, R. 561-5, R. 561-5-1, R. 561-5-2, R. 561-5-4, R. 561-7, R. 561-10-3, R. 561-11-1, and R. 561-12; MLD articles 8(3) and 8(4)(a) as applied to internal policies, controls and procedures regarding recordkeeping of customer due diligence activities; and MFC L. 561-4-1 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) and (3), and 25(1) and (2); MFC L. 533-24, L. 533-24-1, L. 533-12(I), L. 533-12-6, and L. 533-13(I); 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 MFC D. 533-11 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) and (3) and MFC L. 533-11 and L. 533-12.I or MiFID article 30(1) and MFC L. 533-20; and

(ii) MiFID articles 24(4) and (5); MFC L. 533-12(II) and (III) and D. 533-15; MiFID Org Reg articles 46 through 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; MiFIR article 25(1); and Internal Control Order articles 85, 87, 92, and 93; 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); MFC article L. 511-41-1B; Decree of 6 September 2017 article 3; AMF General Regulation article 312-6; and Internal Control Order articles 85, 87, 92, and 93; 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); Decree of 6 September 2017 article 3; and AMF General Regulation article 312-6; 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); MFC article L. 533-10 II, L. 533-14, L. 533-15; and Internal Control Order articles 85, 86, 92, and 93; 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 MFC articles L. 533-10 I and II, L. 533-14, and L. 533-15;

(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; MiFIR article 25(1); and Internal Control Order articles 85, 86, 92, and 93; 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); MFC articles L. 511-41-1-B, L. 511-51 to L. 511-88, L. 533-2-2, L. 533-10 II, L. 533-13, L. 533-14, L. 533-15; Internal Control Order articles 85, 86, 92, and 93; Ministerial Order on the Supervisory Review and Evaluation Process; Decree of 6 September 2017 article 3; and AMF General Regulation article 312-6; 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); Internal Control Order articles 85, 86, 92, and 93; and MFC articles L. 533-13, L. 561-4-1, L. 561-5, L. 561-5-1, L. 561-6, R. 561-5, R.

561-5-1, R. 561-5-2, R. 561-5-3, R. 561-7, R. 561-10 II, R. 561-10-3, R. 561-11-1, R. 561-12, R. 561-15, R. 561-16, R. 561-18, R. 561-19; 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; MFC articles L. 511-41-1-B, L. 511-51 through L. 511-88, L. 533-2-2, L. 533-10 II, L. 533-13, L .533-14, L. 533-15; Internal Control Order articles 85, 86, 92, and 93; Ministerial Order on the Supervisory Review and Evaluation Process; Decree of 6 September 2017 article 3; and AMF General Regulation article 312-6; 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; MFC article L. 511-41-1B; Decree of 6 September 2017 article 3; and AMF General Regulation article 312-6;

(*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 articles 9(1) and 16(3); MFC articles L. 511-55 through L. 511-70, L. 511-89 through L. 511-103, and L. 533-25; and Internal Control Order articles 85, 86, 92, and 93;

(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; MFC article L. 511-41-1B; Decree of 6 September 2017 article 3; and AMF General Regulation article 312-6;

(*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); and MFC article L. 533-10 II, L. 533-13, L. 561-4-1, L. 561-5, L. 561-5-1, L. 561-6, R. 561-5, R. 561-5-1, R. 561-5-2, R. 561-5-3, R. 561-7, R. 561-10 II, R. 561-10-3, R. 561-11-1, R. 561-12, R. 561-15, R. 561-16, R. 561-18, and R. 561-19, 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; MFC articles L. 511-41-1B; L. 533-10 II, L. 621-8-4, L. 621-9, and L. 621-10; Decree of 6 September 2017 article 3; and AMF General Regulation article 312-6;

(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; MFC articles L. 511-41-1B; L. 533-10 II, L. 621-8-4, L. 621-9, and L. 621-10; Decree of 6 September 2017 article 3; and AMF General Regulation article 312-6;

(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); MFC article L. 511-41-1-B, L. 511-51 through L. 511-88, L. 533-2-2, and L. 533-10 II; Decree of 6 September 2017 article 3; AMF General Regulation article 312-6; Ministerial Order on the Supervisory Review and Evaluation Process; and Internal Control Order articles 85, 86, 92, and 93; 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; MFC articles L. 511-41-1-B, L. 511-51 to L. 511-88, L. 533-2-2, L. 533-10 II, L. 533-

10 III, Internal Control Order articles 85, 86, 92, and 93; Ministerial Order on the Supervisory Review and Evaluation Process; Decree of 6 September 2017 article 3; and AMF General Regulation article 312-6;

(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; MiFID Org Reg article 72(1); and Internal Control Order articles 85, 86, 92, and 93;

(*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 MFC articles L. 533-10 II, L. 561-12; 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:

(*1*) 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 MFC article L. 533-10 II; 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:

(*1*) 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; MiFID Org Reg article 72(1); and Internal Control Order articles 85, 86, 92, and 93;

(*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:

(*1*) 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; MFC articles L. 511-41-1-B, L. 511-51 through L. 511-88, L. 533-10 I and II, L. 533-2, L. 533-2-2, and L. 533-12-4; AMF General Regulation articles 314-16, 314-17; Ministerial Order on the Supervisory Review and Evaluation Process; and Internal Control Order articles 94 through 96 and 99 through 102; 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); MFC articles L. 511-41-1-B, L. 511-51 through L. 511-88, L. 533-2-2, L. 533-10 II; Ministerial Order on the Supervisory Review and Evaluation Process; and Internal Control Order articles 94 through 96 and 99 through 102; 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); MLD articles 11 and 13; MiFID Org Reg article 72(1); MiFID article 16(6); and MFC articles L. 533-10 II, L. 561-4-1, L. 561-5, L. 561-5-1, L. 561-6, R. 561-5, R. 561-5-1, R. 561-5-2, R. 561-5-3, R. 561-7, R. 561-10 II, R. 561-10-3, R. 561-11-1, R. 561-12, R. 561-15, R. 561-16, R. 561-18, R. 561-19, 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 MFC article L. 533-10 II; 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); and MFC articles L. 511-55 through L. 511-70, L. 511-89 through L. 511-103, L. 533-10 II, L. 533-25;

(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 MFC article L. 533-10 II; 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:

(*1*) 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 MFC article L. 533-10 II; 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:

(*1*) 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 MFC articles L. 533-10, L. 533-14; 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 MFC articles L. 533-2, L. 533-10 II; 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 MFC articles L. 533-2 and L. 533-10 II.

(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 France;

(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 paragraph (a)(3) of Exchange Act rule 18a-7, 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; MFC articles L. 511-35, L. 511-36, L. 511-37, R. 511-6; and French Commerce Code articles L. 232-1, R. 232-1 through R. 232-8, L. 823-1 through L. 823-8-1; 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; MFC articles L. 511-35, L. 511-36, L. 511-37, L. 511-38 or article L. 533-5, as applicable; MFC articles R. 511-6, L. 511-45, and L. 533-10 II; French Commerce Code articles L. 232-1, R. 232-1 through R. 232-8, L. 823-1 through L. 823-8-1; Decree of 6 September 2017 articles 3 and 10; and AMF General Regulation articles 312-6 and 312-7;

(B) With respect to financial statements, the Covered Entity is required to file annually with the French AMF, 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 French 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 France that the independent public accountant uses to perform audit and attestation services and the accountant complies with French 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 France that the independent public accountant uses to perform audit and attestation services and the accountant complies with French independence requirements;

(*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); MFC articles L. 511-33II, L. 634-1, and L. 634-2; and Internal Control Order article 249 and 249-1; 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;

(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 MFC articles L. 511-33II, L. 634-1, and L. 634-2; and Internal Control Order article 249 and 249-1.

(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 MFC articles L. 511-33II, L. 634-1, and L. 634-2; and Internal Control Order article 249 and 249-1; 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 MFC articles L. 511-33II, L. 634-1, and L. 634-2; and Internal Control Order article 249 and 249-1;

(*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 French 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) 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 paragraphs (a)(2) and (b)(3) of Exchange Act rule 18a-8 relating to Exchange Act rule 18a-2; and

(C) This Order does not extend to the requirements of paragraph (g) of Exchange Act rule 18a-8 or to the requirements of Exchange Act rule 18a-8(h) as applied to the requirements of paragraph (g) of Exchange Act 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; MiFID Delegated Directive articles 2 and 8; Decree of 6 September 2017 articles 3 and 10; and AMF General Regulation articles 312-6 and 312-7; 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 MFC articles L. 533-10 II and L. 533-10 III; 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 authorized by the ACPR to provide investment services or perform investment activities in the French Republic, or a credit institution authorized by the ACPR, after approval by the AMF of its program of operations, to provide investment services

or perform investment activities in the French Republic, and supervised by the AMF under its Tier 1 framework.

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

(3) “MFC” means France’s “Code monétaire et financier,” as amended from time to time.

(4) “Internal Control Order” means the French AMF’s Arrêté of 3 November 2014 on Internal Control of Companies in the Banking, Payment Services and Investment Services Sector Subject to the Supervision of the Authorité de Contrôle Prudentiel et de Résolution, as amended from time to time.

(5) “Prudential Supervision and Risk Assessment Order” means the French ministerial order on prudential supervision and risk assessment, as amended from time to time.

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

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

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

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

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

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

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

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

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

(16) “AMF” means the French Autorité des Marchés Financiers.

(17) “ACPR” means the French Authorité de Contrôle Prudentiel et de Résolution.

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

(19) “Accounting Directive” means Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013, as amended from time to time.

(20) “Decree of 6 September 2017” means France’s Decree number 2017-1324 of 6 September 2017, as amended from time to time.

(21) “AMF General Regulation” means France’s “Règlement Général de L’Autorité des Marchés Financiers,” as amended from time to time.

(22) “Ministerial Order on the Supervisory Review and Evaluation Process” means France’s Arrêté of 3 November 2014 on the Process for Prudential Supervision and Risk Assessment of Banking Service Providers and Investment Firms Other than Portfolio Management Companies, as amended from time to time.

(23) “French Commerce Code” means the French Commercial Code, as amended from time to time.

(24) “Prudentially regulated” means a Covered Entity that has a “prudential regulator” as that term is defined in Exchange Act section 3(a)(74).

(25) “Decree of 3 November 2014 relating to capital buffers” means Arrêté of 3 November 2014 relating to the capital buffers of banking service providers and investment firms other than portfolio management companies, as amended from time to time.

(26) “BRRD” means Bank Recovery and Resolution Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014, as amended from time to time.

(27) “Decree of 20 February 2007 relating to prudential requirements” means Arrêté of 20 February 2007 relating to prudential requirements applicable to credit institutions and investment firms, as amended from time to time.

By the Commission.

Vanessa A. Countryman,

Secretary.

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