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Trade Acknowledgment and Verification of Security-Based Swap  
Transactions; Final Rule

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Part 240

[Release No. 34-78011; File No. S7-03-11]

RIN 3235-AK91

### Trade Acknowledgment and Verification of Security-Based Swap Transactions

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** In accordance with Section 764(a) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”), the Securities and Exchange Commission (“Commission”) is adopting Rules 15Fi-1 and 15Fi-2 under the Securities Exchange Act of 1934 (“Exchange Act”) requiring security-based swap dealers and major security-based swap participants to provide trade acknowledgments and to verify those trade acknowledgments in security-based swap transactions. The Commission also is amending Rule 3a71-6 under the Exchange Act to address the potential availability of substituted compliance in connection with those trade acknowledgment and verification requirements.

**DATES:** *Effective Date:* August 16, 2016. *Compliance date:* The applicable compliance date is discussed in Section V of this final rule.

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## I. Introduction

### A. Trade Acknowledgment and Verification

Section 764 of the Dodd-Frank Act,<sup>1</sup> enacted on July 21, 2010, added Section 15F to the Exchange Act.<sup>2</sup> Among other things, Section 15F requires security-based swap (“SBS”) dealers<sup>3</sup> and major SBS participants<sup>4</sup> (together, “SBS Entities”) to register with the Commission, and directs the Commission to prescribe rules applicable to SBS Entities.

Section 15F(i)(1) of the Exchange Act provides that registered SBS Entities

<sup>1</sup> Pub. L. 111-203, 124 Stat. 1376, 1784 (2010).

<sup>2</sup> 15 U.S.C. 78o-8.

<sup>3</sup> See Exchange Act Section 3(a)(71)(A) [15 U.S.C. 78c(71)(A)] and Rule 3a71-1 [17 CFR 240.3a71-1]; see also Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, Exchange Act Release No. 66868 (Apr. 27, 2012), 77 FR 30596 (May 23, 2012) (“Intermediary Definitions Adopting Release”) and Application of “Security-Based Swap Dealer” and “Major Security-Based Swap Participant” Definitions to Cross-Border Security-Based Swap Activities; Republication, Exchange Act Release No. 72472 (Jun. 25, 2014), 79 FR 47278 (Aug. 12, 2014) (“Cross-Border Adopting Release”).

<sup>4</sup> See Exchange Act Section 3(a)(67) [15 U.S.C. 78c(67)] and Rule 3a67-1 [17 CFR 240.3a67-1]; see also Intermediary Definitions Adopting Release and Cross-Border Adopting Release.

shall conform with such standards as may be prescribed by the Commission, by rule or regulation, that relate to timely and accurate confirmation, processing, netting, documentation, and valuation of all security-based swaps. Section 15F(i)(2) of the Exchange Act requires the Commission to adopt rules governing documentation standards for SBS Entities. Pursuant to this authority, the Commission published proposed Rule 15Fi-1 for public comment.<sup>5</sup> The proposed rule prescribed standards intended to provide for timely and accurate confirmation of SBS transactions, as discussed more fully below.

The Commission proposed Rule 15Fi-1 to promote the efficient operation of the SBS market, and to facilitate market participants' management of their SBS-related risk.<sup>6</sup> The proposed rule was intended to help avoid a recurrence of documentation backlogs that had persisted in the industry prior to the adoption of the Dodd-Frank Act, and to help address concerns expressed by the Government Accountability Office regarding the documentation of credit derivatives.<sup>7</sup> In particular, the proposed rule was intended to reduce the risk a court may have to supply contract terms upon which there was no previous agreement.<sup>8</sup> Furthermore, unconfirmed trades could allow errors to go undetected that might subsequently lead to losses and other problems, such as an SBS Entity's inaccurately measuring and managing its risk exposures.<sup>9</sup> Such operational risks have the potential to contribute to broader market problems.<sup>10</sup>

If an SBS transaction is not reduced to writing, there is no definitive written record of the contract terms to which the counterparties have agreed, which can lead to legal and operational risk for market participants. For this reason, prudent practice requires that, after coming to an agreement on the terms of an SBS transaction, the counterparties document the transaction in a complete and definitive written record so there is certainty about the terms of their agreement in case those terms are later disputed. The Commission understands

that market participants generally issue a "trade acknowledgment" (sometimes referred to by market participants as a "draft confirmation" or an "alleged trade") to memorialize the economic and related terms of an SBS transaction, regardless of the means by which the transaction was executed. The Commission also understands that industry best practices incorporate a process by which the counterparties verify that the trade acknowledgment accurately reflects the terms of their trade.<sup>11</sup> This process, through which one counterparty acknowledges an SBS transaction and its counterparty verifies it, is the confirmation process, which results in the issuance of a confirmation that reflects the terms of the contract between the counterparties.<sup>12</sup> This confirmation generally includes any transaction-specific modifications to master agreements between the counterparties that might apply to the transaction, such as the International Swaps and Derivatives Association ("ISDA") Master Agreement and Schedule. A confirmation is thus a written or electronic record of an SBS transaction that has been sent by one counterparty to its counterparty and then manually, electronically, or by some other legally equivalent means, signed (*i.e.*, verified) by the receiving counterparty.

Proposed Rule 15Fi-1 generally would have required that an SBS Entity provide a trade acknowledgment containing certain information memorializing an SBS transaction to its counterparty. If more than one counterparty to the SBS transaction is an SBS Entity, the proposed rule specified which counterparty would be required to provide the trade acknowledgment. The proposed rule also would have required an SBS Entity to establish, maintain, and enforce written policies and procedures that are reasonably designed to obtain prompt verification of the terms of a trade acknowledgment. In addition, an SBS Entity would have been required to promptly verify the accuracy of, or otherwise dispute with its counterparty, the terms of any trade acknowledgment that it receives. The proposed rule is

described more fully below in Section II.

The comment period for proposed Rule 15Fi-1 ended on February 22, 2011. On May 1, 2013, the Commission reopened the comment period for proposed Rule 15Fi-1 and sought comment on, among other things, the relationship of the proposed rule to any parallel requirements of other authorities, including the CFTC and relevant foreign regulatory authorities and, with respect to the CFTC rules, whether the Commission's rules should emphasize consistency with the CFTC rules or be more tailored to the security-based swap market.<sup>13</sup> The Commission received seven comments in total on proposed Rule 15Fi-1.<sup>14</sup> As discussed more fully in Section II below, commenters generally supported the proposed rule but suggested modifications to certain provisions.

After careful consideration of the comments, the Commission is adopting Rules 15Fi-1 and 15Fi-2 (each a "Final Rule") with certain modifications to the proposal as discussed below in Section II. These changes generally are intended to address concerns expressed by some commenters and to bring the rule into greater conformity with the CFTC Rule. The Commission has also modified the proposal to separate the proposed rule into two rules. Final Rule 15Fi-1 contains the definitions, which are redesignated as paragraphs (a) through (i) of Final Rule 15Fi-1. Final Rule 15Fi-2 contains the substantive trade acknowledgment and verification

<sup>13</sup> Reopening of Comment Periods for Certain Rulemaking Releases and Policy Statement Applicable to Security-Based Swaps, Exchange Act Release No. 69491 (May 1, 2013), 78 FR 30800 (May 23, 2013). The CFTC adopted its final rule on swap confirmation, 17 CFR 23.501 ("CFTC Rule"), in 2012. See Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904 (Sept. 11, 2012) ("CFTC Adopting Release").

<sup>14</sup> Comments were received from Chris Barnard, dated Jan. 22, 2011 ("Barnard"); Robert Pickel, Executive Vice Chairman, International Swaps and Derivatives Association, Inc., dated Feb. 22, 2011 ("ISDA I"); Jeff Gooch, Chief Executive Officer, MarkitSERV, dated Feb. 22, 2011 ("MarkitSERV"); Anonymous, dated Feb. 19, 2011 ("Anonymous"); Dennis Kelleher, President & CEO, and Stephen W. Hall, Securities Specialist, Better Markets, Inc., dated Jul. 22, 2013 ("Better Markets I"); Robert G. Pickel, Chief Executive Officer, International Swaps and Derivatives Association, Inc., dated Jul. 22, 2013 ("ISDA II"); and Financial Services Roundtable, Futures Industry Association, Institute of International Bankers, International Swaps and Derivatives Association, Investment Company Institute, Securities Industry and Financial Markets Association, dated May 21, 2013 (in relevant part, this letter requested that the Commission grant additional time for the commenters to analyze the implications of the Commission's cross-border proposal on certain rules, including the Proposed Rule that the Commission reopened for comment).

<sup>5</sup> Trade Acknowledgment and Verification of Security-Based Swap Transactions, Exchange Act Release No. 63727 (Jan. 14, 2011), 76 FR 3859 (Jan. 21, 2011) ("Proposing Release").

<sup>6</sup> See Proposing Release, 76 FR at 3861.

<sup>7</sup> See Proposing Release, 76 FR at 3860-61, and Section VII.A, *infra*.

<sup>8</sup> See Proposing Release, 76 FR at 3860.

<sup>9</sup> U.S. Gov't Accountability Office, GAO-07-716, Confirmation Backlogs Increased Dealers' Operational Risks, but Were Successfully Addressed After Joint Regulatory Action (2007) ("GAO Confirmation Report") at 15.

<sup>10</sup> *Id.*

<sup>11</sup> See Part II.E, below, for a discussion of verification.

<sup>12</sup> Confirmations may also be used by an SBS Entity to make certain disclosures, or to disclaim certain obligations, to a counterparty. The Commission has separately adopted rules governing required disclosures by an SBS Entity in connection with business conduct rules for SBS Entities. See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 77617 (Apr. 14, 2016), 81 FR 29960 (May 13, 2016) ("Business Conduct Adopting Release").

requirements, an exception for clearing transactions, an exception for certain transactions that are executed on a security-based swap execution facility (“SBSEF”) or a national securities exchange or that are accepted for clearing by a clearing agency, and the exemption from Rule 10b–10.

Final Rule 15Fi–2 generally requires an SBS Entity to provide a trade acknowledgment through electronic means disclosing all the terms of a security-based swap transaction to its counterparty promptly, but in any event no later than the end of the first business day following the day of execution. Final Rule 15Fi–2 also requires an SBS Entity to establish, maintain, and enforce written policies and procedures that are reasonably designed to obtain prompt verification of the terms of a trade acknowledgment, and to promptly verify the accuracy of, or otherwise dispute with its counterparty, the terms of a trade acknowledgment it receives. In addition, Final Rule 15Fi–2 provides an exception from the requirement to send a trade acknowledgment for clearing transactions and an exception for certain security-based swap transactions executed on an SBSEF or a national securities exchange, or accepted for clearing by a clearing agency. Finally, Final Rule 15Fi–2 provides to an SBS Entity that is also a broker or dealer an exemption from Exchange Act Rule 10b–10 if the SBS Entity provides a trade acknowledgment, or timely verifies or disputes the terms of a trade acknowledgment that it receives, in compliance with the Final Rules.

Final Rules 15Fi–1 and 15Fi–2 reflect deliberation by the Commission of the way that its rules could affect the security-based swap market. The Commission has sought to adopt rules that take into account current market practices while providing appropriate protections for investors’ interests and to promote the purposes of the Exchange Act. In developing these rules, Commission staff consulted and coordinated with the CFTC and the prudential regulators.<sup>15</sup>

### B. Cross-Border Application and Availability of Substituted Compliance

In 2013, the Commission proposed rules and interpretive guidance to address the cross-border application of Title VII, including requirements

applicable to security-based swap dealers and major security-based swap participants.<sup>16</sup> The Commission in particular expressed the preliminary view that the Title VII requirements apply generally to the activities of registered security-based swap dealers and major security-based swap participants.<sup>17</sup> The Commission also proposed rules that would provide that a registered foreign security-based swap dealer, a foreign branch of a registered U.S. security-based swap dealer or a foreign major security-based swap participant, with respect to their foreign business, shall not be subject to certain transaction-level business conduct requirements.<sup>18</sup>

As part of that Cross-Border Proposing Release, the Commission also proposed rules to establish a framework to permit market participants to satisfy certain requirements by complying with comparable regulatory requirements of a foreign jurisdiction. Among these was a proposed rule by which foreign security-based swap dealers registered with the Commission might satisfy requirements under Exchange Act Section 15F—other than dealer registration requirements—by complying with the corresponding rules and regulations established in a foreign jurisdiction.<sup>19</sup>

As discussed below, a number of commenters to the Cross-Border Proposing Release addressed various aspects of the proposed substituted compliance framework for security-based swap dealers.

As discussed below, moreover, the Commission is setting forth its interpretation regarding the cross-border scope of the trade acknowledgment and verification requirements. The Commission also is amending Rule

3a71–6 to provide that when the Commission has made a substituted compliance determination, non-U.S. SBS Entities may satisfy the trade acknowledgment and verification requirements applicable to SBS Entities by complying with comparable requirements of a foreign regime.

## II. Discussion of Trade Acknowledgment and Verification Rule

### A. Definitions

#### 1. Proposed Rule

We proposed to define several key terms in Rule 15Fi–1 to have the meaning that we believe is commonly attributed to those terms by industry participants. Thus, we proposed to define the term “trade acknowledgment” to mean a written or electronic record of an SBS transaction sent by one party to the other.<sup>20</sup> We also proposed that the term “verification” would mean the process by which a trade acknowledgment has been manually, electronically, or by some other legally equivalent means, signed by the receiving counterparty,<sup>21</sup> and that a “confirmation” of an SBS transaction would mean a trade acknowledgment that has been verified.<sup>22</sup> “Execution” would have been defined to mean the point at which the parties become irrevocably bound to a transaction under applicable law.<sup>23</sup>

Proposed Rule 15Fi–1 also would have defined certain items that SBS Entities would have been required to include on a trade acknowledgment, including “asset class”;<sup>24</sup> “broker ID”;<sup>25</sup> “desk ID”;<sup>26</sup> “participant ID”;<sup>27</sup> “price”;<sup>28</sup> and “trader ID”.<sup>29</sup> UIC was also defined to mean the unique identification code assigned to a person, unit of a person, or product by or on behalf of an internationally recognized

<sup>16</sup> See Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 69490 (May 1, 2013), 78 FR 30968, 30986 (May 23, 2013) (“Cross-Border Proposing Release”).

<sup>17</sup> See notes 191 to 195, *infra*, and accompanying text.

<sup>18</sup> See note 197, *infra*, and accompanying text.

<sup>19</sup> See Cross-Border Proposing Release, 78 FR at 31088, 31207–08 (proposed Exchange Act Rule 3a71–5). In adopting final rules related to the registration requirements applicable to security-based swap dealers, the Commission stated that substituted compliance would not be available in connection with those registration requirements. See Exchange Act Release No. 75611 (Aug. 5, 2015), 80 FR 48964, 48972–73 (Aug. 14, 2015) (“Registration Adopting Release”). Also, in 2014, the Commission adopted a final procedural rule regarding the submission of requests for substituted compliance determinations. See Cross-Border Adopting Release, 79 FR at 47357–60, 47369 (Exchange Act Rule 0–13).

<sup>20</sup> See proposed Rule 15Fi–1(a)(10).

<sup>21</sup> See proposed Rule 15Fi–1(a)(13).

<sup>22</sup> See proposed Rule 15Fi–1(a)(4).

<sup>23</sup> See proposed Rule 15Fi–1(a)(6).

<sup>24</sup> See proposed Rule 15Fi–1(a)(1) (defining the term to mean “those security-based swaps in a particular broad category, including, but not limited to, credit derivatives, equity derivatives, and loan-based derivatives”).

<sup>25</sup> See proposed Rule 15Fi–1(a)(2) (defining the term to mean “the unique identification code (“UIC”) assigned to a person acting as a broker for a participant”).

<sup>26</sup> See proposed Rule 15Fi–1(a)(5) (defining the term to mean “the UIC assigned to the trading desk of a participant or of a broker of a participant”).

<sup>27</sup> See proposed Rule 15Fi–1(a)(7) (defining the term to mean “the UIC assigned to a participant”).

<sup>28</sup> See proposed Rule 15Fi–1(a)(8) (defining the term to mean “the price of a security-based swap transaction, expressed in terms of the commercial conventions used in that asset class”).

<sup>29</sup> See proposed Rule 15Fi–1(a)(11) (defining the term to mean “the UIC assigned to a natural person who executes security-based swaps”).

<sup>15</sup> Section 712(a)(2) of the Dodd-Frank Act provides in part that the Commission shall “consult and coordinate to the extent possible with the Commodity Futures Trading Commission and the prudential regulators for the purpose of assuring regulatory consistency and comparability, to the extent possible.”

standards-setting body that imposes fees and usage restrictions that are fair and reasonable and not unreasonably discriminatory.<sup>30</sup> These terms were proposed to be defined as in the proposed rules for reporting and public dissemination of SBS.<sup>31</sup>

Proposed Rule 15Fi-1 also would have defined “clearing agency” for purposes of the rule to mean a clearing agency registered pursuant to Section 17A of the Securities Exchange Act of 1934.<sup>32</sup> In addition, the proposed rule would have defined “processed electronically” to mean entered into a security-based swap dealer or security-based swap participant’s computerized processing systems to facilitate clearance and settlement.<sup>33</sup>

## 2. Comments

Two commenters requested that the Commission clarify the meanings of certain terms used in the proposal, particularly “executed electronically” and “processed electronically.”<sup>34</sup> One commenter noted that there are a variety of systems and communication devices that may be used and that may have different assortments of features, and stated its view that it would be inappropriate to include in these terms all transactions for which some element of the transaction is captured or processed through electronic means.<sup>35</sup> This commenter suggested that the Commission define “processed electronically” with reference to a trading facility’s electronic processing system.<sup>36</sup> The other commenter suggested that the term “processed electronically” be defined as “entered into a [SBS Dealer] or [Major SBS Participant]’s computerized processing systems to facilitate clearance and settlement, as well as to become capable of being communicated electronically to the counterparty either as trade acknowledgment or as trade verification.”<sup>37</sup>

<sup>30</sup> See proposed Rule 15Fi-1(a)(12). Proposed Rule 15Fi-1(a)(12) also provided that if no standards-setting body meets these criteria, a registered security-based swap data repository shall assign all necessary UICs using its own methodology. If a standards-setting body meets these criteria but has not assigned a UIC to a particular person, unit of a person, or product, a registered security-based swap data repository shall assign a UIC to that person, unit of a person, or product using its own methodology.

<sup>31</sup> See Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 63346 (Nov. 19, 2010), 75 FR 75207 (Dec. 2, 2010) (“SBSR Proposing Release”).

<sup>32</sup> See proposed Rule 15Fi-1(a)(3).

<sup>33</sup> See proposed Rule 15Fi-1(a)(9).

<sup>34</sup> ISDA I at 5; MarkitSERV at 2, 9.

<sup>35</sup> ISDA I at 5.

<sup>36</sup> *Id.*

<sup>37</sup> MarkitSERV at 9.

## 3. Response to Comments and Final Rule

We did not receive any comments on, and we are adopting as proposed the definition for the term “verification” in Final Rule 15Fi-1. Final Rule 15Fi-1(e) as adopted defines the term “execution” substantially as proposed, except we have changed a reference to “parties” in a transaction to “counterparties” to clarify that we are referring to the same persons in each part of the rule where the term is used. Final Rule 15Fi-1(f) adopts the term “trade acknowledgment” substantially as proposed, except that the definition is clarified by changing a reference to a “party” to “counterparty of the security-based swap transaction” for the same reason discussed above. Final Rule 15Fi-1 also defines the terms “clearing transaction” as discussed further in Section II.F. below, “business day” and “day of execution” as discussed further in Section II.C. below, and “security-based swap execution facility” and “national securities exchange” as discussed further in Section II.G. below. In addition, Final Rule 15Fi-1(b) as adopted defines the term “clearing agency” differently than the proposed rule for reasons discussed further in Section II.F. below.

The term “executed electronically” is not being adopted as part of Final Rule 15Fi-1 as a result of changes, discussed in Section II.C. below, made to the rule’s timing requirements. The Commission also is not adopting the definition of “processed electronically,”<sup>38</sup> due to changes in Final Rule 15Fi-2’s timing requirements and the elimination of the requirement for electronic processing.<sup>39</sup> In addition, as discussed further in Section II.D. below, Final Rule 15Fi-2 does not contain an enumerated list of items that are required to be disclosed on the trade acknowledgment, and thus the Commission is not adopting definitions for the terms “asset class,” “broker ID,” “desk ID,” “participant ID,” “price,” “trader ID,” or “UIC,” which were proposed only to define the enumerated contents of the trade acknowledgment. Finally, Final Rule 15Fi-1 does not adopt the term “confirmation,” which is not used elsewhere in Final Rules 15Fi-1 or 15Fi-2.

<sup>38</sup> See proposed Rule 15Fi-1(c)(1)(i) and (ii) (which would have required SBS transactions to be acknowledged within 15 minutes for transactions that were electronically executed and processed electronically, and within 30 minutes for transactions that were not electronically executed but were processed electronically).

<sup>39</sup> See *infra*, Section II.C.

## B. Trade Acknowledgment Requirement

### 1. Proposed Rule

Proposed Rule 15Fi-1(b) would have required an SBS Entity to provide a trade acknowledgment to its counterparty when it purchases an SBS from, or sells an SBS to, the counterparty. As noted in the Proposing Release, the terms “purchase” and “sale” are defined in Sections 3(a)(13) and (14), respectively, of the Exchange Act.<sup>40</sup> As amended by the Dodd-Frank Act, those definitions as applied to SBS transactions include any “execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap.”<sup>41</sup> Because the proposed rule would apply solely to an SBS Entity that “purchases” or “sells” an SBS, the proposed rule would be effectively limited to “principal transactions” in which the SBS Entity is a counterparty to the transaction and is acting for its own account.

Proposed Rule 15Fi-1(b) also stated which counterparty that is an SBS Entity to a security-based swap transaction has the responsibility to provide a trade acknowledgment. Specifically, proposed Rule 15Fi-1(b) would have required that, in a transaction between an SBS dealer and a major SBS participant, the SBS dealer would be responsible for providing the trade acknowledgment.<sup>42</sup> In a transaction where only one counterparty is an SBS dealer or major SBS participant, the SBS dealer or major SBS participant would be responsible for providing the trade acknowledgment.<sup>43</sup> In any other transaction involving SBS Entities, the counterparties would be required to select which counterparty would provide the trade acknowledgment.<sup>44</sup> The rule therefore

<sup>40</sup> See Proposing Release, 76 FR at 3861; see also 15 U.S.C. 78c(a)(13) and (14).

<sup>41</sup> Dodd-Frank Act Sections 761(a)(3) and (4), amending Exchange Act Sections 3(a)(13) and (14), respectively; 15 U.S.C. 78c(a)(13) and (14).

<sup>42</sup> See proposed Rule 15Fi-1(b)(1)(i).

<sup>43</sup> See proposed Rule 15Fi-1(b)(1)(ii).

<sup>44</sup> See proposed Rule 15Fi-1(b)(1)(iii). For most transactions subject to the proposed rule, the party responsible for providing the trade acknowledgment would be determined in a similar manner to the party responsible for reporting the transaction under proposed Regulation SBSR. As discussed in the Proposing Release, the Commission used Section 13A(a)(3) of the Exchange Act as a model in proposed Rule 15Fi-1 to determine which counterparty would be responsible for providing the trade acknowledgment in the transaction. See Proposing Release, 76 FR at 3862. Section 13A(a)(3) specifies which party is obligated to report certain SBS transactions—an SBS dealer, a major SBS

would have applied only to SBS Entities, thus there would have been no requirement to provide a trade acknowledgment in a transaction that does not involve an SBS Entity.

The Commission stated in the Proposing Release that it expected that many transactions would be confirmed by “matching services” provided through a clearing agency, noting that it used the term “matching services” in the Proposing Release to refer only to services through which two counterparties enter a new transaction.<sup>45</sup> The Commission also noted in the Proposing Release that a clearing agency is providing matching services if it captures trade information regarding a securities transaction, performs an independent comparison of that information, and issues a confirmation of the transaction.<sup>46</sup> The Commission stated that the use of clearing agencies’ matching services would promote the principles of Exchange Act Section 15F(i) and that it wished to encourage SBS Entities to use these matching services. Accordingly, paragraph (b)(2) of the proposed rule would have provided that an SBS Entity would have satisfied its requirement to provide a trade acknowledgment if a clearing agency, through its matching service facilities, produced a confirmation of the SBS transaction.<sup>47</sup>

The Commission also noted in the Proposing Release that a clearing agency may also serve as a central counterparty (“CCP”) in SBS transactions whereby the counterparties may novate their contracts to the CCP.<sup>48</sup> The novation would constitute a purchase from or a sale to the clearing agency in the agency model of clearing which predominates in the United States.<sup>49</sup> In the agency model, a swap that is accepted for clearing—often referred to in the industry as an “alpha”—is terminated and replaced with two new swaps,

participant, or a counterparty to the transaction. 15 U.S.C. 78m–1(a)(3).

<sup>45</sup> See Proposing Release, 76 FR at 3862.

<sup>46</sup> *Id.* “Confirmation” was proposed to mean a trade acknowledgment that has been subject to verification. See proposed Rule 15Fi–1(a)(4).

<sup>47</sup> See Proposing Release, 76 FR at 3862 and n.22.

<sup>48</sup> In the Proposing Release, the Commission noted its understanding that in a CCP arrangement, if the original counterparties to a bilateral SBS transaction are clearing members, they may novate their bilateral trade to the clearing agency (acting as a CCP). In such a novation to a CCP, each counterparty may terminate its contract with the other and enter into a new contract on identical terms with the CCP. In this way, the CCP would become buyer to one counterparty and seller to the other. See Proposing Release, 76 FR at 3862.

<sup>49</sup> See Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 74244 (Feb. 11, 2015), 80 FR 14564 at 14599 (Mar. 19, 2015) (“SBSR Adopting Release”).

known as “beta” and “gamma.”<sup>50</sup> Therefore, such a novation would involve three security-based swap transactions: The initial bilateral contract between the counterparties, a new transaction between the CCP and one of the counterparties to the initial bilateral contract, and a new transaction between the CCP and the other counterparty to the initial bilateral contract. Under proposed Rule 15Fi–1, if an SBS entity were a counterparty to the bilateral transaction, it would be subject to the trade acknowledgment requirement. Further, any subsequent transaction in which an SBS Entity novated the transaction to a CCP would also be subject to the trade acknowledgment requirement. While the purchase or sale would require that an SBS Entity provide a trade acknowledgment under paragraph (b)(1) of the proposed rule, paragraph (b)(2) of the proposed rule would have permitted the CCP to satisfy the SBS Entity’s obligation to provide a trade acknowledgment to the SBS Entity’s counterparty, both for the initial bilateral transaction between an SBS Entity and its counterparty, and for the subsequent purchases or sales that result from the novation to the CCP.

## 2. Comments

Commenters focused on paragraph (b)(2) of proposed Rule 15Fi–1, which would have permitted a clearing agency to provide a trade acknowledgment on behalf of an SBS Entity. One commenter suggested that SBS Entities should be permitted to delegate their recordkeeping responsibilities to qualified third parties.<sup>51</sup>

One commenter indicated its view that an SBS Entity should be able to satisfy the proposed rule’s requirements merely by executing the transaction on a swap execution facility or a designated contract market, or by clearing the swap through a derivatives clearing organization.<sup>52</sup> Another commenter believed, however, that execution platforms would not hold all the data necessary to bilaterally confirm trades, either because the data is assumed at execution (such as payment frequency) or because the execution platform lacks bilaterally specific terms (such as the master confirmation agreement type and date).<sup>53</sup> These comments are addressed in Sections II.F and II.G below.

One commenter also maintained that any swap execution facility, designated contract market, or derivatives clearing

organization that provides confirmations should be required to meet all the regulatory requirements applicable to clearing agencies that provide confirmations.<sup>54</sup> Alternatively, the commenter suggested that the Commission provide an exemption from registration as a clearing agency for “confirmation clearing agencies,” or otherwise provide a conditional exemption from registration that would apply only relevant requirements to confirmation clearing agencies.<sup>55</sup> The commenter also suggested that the registration requirements applicable to entities that must register with the Commission as clearing agencies for providing confirmation services should be fair and apply to all entities that provide similar acknowledgment, verification, and confirmation services.<sup>56</sup> Moreover, the commenter indicated that “confirmation clearing agencies” should be subject to a more limited scope of clearing agency regulation than credit-substituting central clearing counterparties, or should receive an exemption from certain requirements that the commenter viewed as irrelevant.<sup>57</sup>

## 3. Response to Comments and Final Rule

We did not receive any comments on proposed paragraph (b)(1) of the proposed rule, and are adopting it as proposed but re-designating it as Rule 15Fi–2(a). We are also making a technical change to paragraph (b)(3) of proposed rule 15Fi–1, changing the word “in” to “by” in one place, re-designating the rule as Rule 15Fi–2(a), and updating cross references in the paragraph to the re-designated rule numbers as appropriate.

In response to comments, the Commission is not adopting paragraph (b)(2) of proposed Rule 15Fi–1, which would have permitted a clearing agency to provide a trade acknowledgment on behalf of an SBS Entity. After further consideration and in response to the comments, we believe that it is appropriate to permit an SBS Entity to rely on a third party of its choice to provide a trade acknowledgment on its behalf because it will allow SBS Entities flexibility to select a provider of these services even if the provider is not a registered clearing agency. The Final Rules do not restrict an SBS Entity’s ability to use a third party of its choice to provide a trade acknowledgment. Eliminating paragraph (b)(2) of the

<sup>50</sup> *Id.*

<sup>51</sup> MarkitSERV at 2.

<sup>52</sup> ISDA I at 5.

<sup>53</sup> MarkitSERV at 5.

<sup>54</sup> *Id.* at 7.

<sup>55</sup> *Id.* at 6.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

proposed rule will also make the Final Rules more consistent with the CFTC Rule, which does not impose any limitation on which third parties may provide a swap trade acknowledgment or confirmation on behalf of a swap dealer or major swap participant (“Swap Entities”).<sup>58</sup> Thus, SBS Entities that are also Swap Entities may use the same third parties to provide trade acknowledgments pursuant to Final Rule 15Fi-2 that they use to comply with the CFTC Rule<sup>59</sup> without regard to whether those third parties are registered as clearing agencies. This may simplify dually-registered SBS Entities’ operations or help to mitigate their costs of compliance. However, the Commission emphasizes that the SBS Entity remains responsible for complying with Final Rule 15Fi-2.

We do, however, recognize the role of a clearing agency in security-based swap transactions to which it is a counterparty. Thus, Final Rule 15Fi-2 also provides an exception from an SBS Entity’s general requirement to provide a trade acknowledgment for: (1) Clearing transactions, as discussed in Section II.G below; and (2) SBS transactions that are submitted for clearing at a clearing agency, if the transaction is submitted for clearing as soon as technologically practicable, but in any event no later than the time established for providing a trade acknowledgment under the rule; and the rules, procedures or processes of the clearing agency provide for the acknowledgment and verification of all the terms of the transaction prior to or at the same time that the SBS is accepted for clearing, as discussed in Section II.G below.<sup>60</sup> We also recognize that executing an SBS transaction on an SBSEF may provide the counterparties a means of providing a trade acknowledgment and verifying the transaction and, as discussed further in Section II.G. below, we are excepting certain transactions executed on an SBSEF from the requirement that the counterparties provide a trade acknowledgment.<sup>61</sup>

<sup>58</sup> Two commenters encouraged the SEC and the CFTC to harmonize their rules. MarkitSERV at 9, ISDA II at 3, 8.

<sup>59</sup> See 17 CFR 23.501.

<sup>60</sup> See also *infra* Section II.G., which discusses an exception from trade acknowledgment and verification requirements for SBS transactions executed on an SBSEF or national securities exchange, subject to certain conditions.

<sup>61</sup> We are not addressing at this time when a third-party provider of trade acknowledgment and confirmation services, such as one that provides matching services as discussed in the Proposing Release, would be required to register as a clearing agency. In 2011, the Commission issued a temporary conditional exemption from the registration requirement under Section 17A(b)(1) of the Exchange Act for any clearing agency that may

### C. Time To Provide a Trade Acknowledgment

#### 1. Proposed Rule

Proposed Rule 15Fi-1(c) would have provided that the maximum time for providing a trade acknowledgment of an SBS transaction would vary depending upon whether the transaction was electronically executed or electronically processed, but would not exceed 24 hours following execution. Specifically, proposed Rule 15Fi-1(c)(1) would have required any SBS transaction to be confirmed promptly, but in any event:

- For any transaction that has been executed and processed electronically, a trade acknowledgment must be provided within 15 minutes of execution.
- For any transaction that is not electronically executed, but that will be processed electronically, a trade acknowledgment must be provided within 30 minutes of execution.
- For any transaction that the SBS Entity cannot process electronically, a trade acknowledgment must be provided within 24 hours following execution.

The Commission stated that it encourages SBS Entities to minimize the number of manual transactions processed, and to process electronically all SBS transactions if it is reasonably practicable to do so.<sup>62</sup> However, the Commission also stated that it understands that an SBS Entity may have the ability to process electronically only certain SBS transactions. For example, an SBS Entity may have the ability to process electronically certain standardized SBS transactions in certain asset classes, or transactions that it executes on an exchange or SBS execution facility, but may lack the ability to process electronically SBS transactions in other asset classes or that are executed by other means.<sup>63</sup> The

be required to register with the Commission solely as a result of providing collateral management services, trade matching services, tear up and compression services, and/or substantially similar services for SBS (“Exempted Activities”). See Order Pursuant to Section 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions from Clearing Agency Registration Requirements under Section 17A(b) of the Exchange Act for Entities Providing Certain Clearing Services for Security-Based Swaps, Exchange Act Release No. 64796 (July 1, 2011). The order provides a temporary exemption, until the compliance date for the final rules relating to registration of clearing agencies that clear security-based swaps pursuant to Sections 17A(i) and (j) of the Exchange Act, from Section 17A(b)(1) of the Exchange Act to persons conducting Exempted Activities. *Id.*

<sup>62</sup> See Proposing Release, 76 FR at 3863.

<sup>63</sup> The Commission noted that transactions in non-standardized SBS that are individually negotiated and contain unique terms, or transactions effected telephonically and processed

Commission also stated that an SBS Entity’s ability to process a transaction electronically may be limited by its counterparty’s abilities.<sup>64</sup> For example, an SBS Entity may have the ability to process an SBS transaction through a matching facility, but if its counterparty lacks access to the matching facility, it would need to process transactions with that counterparty through non-computerized means.

Proposed Rule 15Fi-1(c)(2) would have provided that an SBS Entity would be required to process electronically an SBS transaction if it has the ability to do so. In other words, an SBS Entity could not delay providing a trade acknowledgment by choosing to process a transaction by non-electronic means. The Commission stated its preliminary view that requiring SBS Entities to acknowledge trades as promptly as they are able to do so would promote the purposes of Exchange Act Section 15Fi-1.<sup>65</sup>

The proposed requirements were intended to promote the stability of the SBS market by preventing documentation backlogs from creating uncertainty over SBS Entities’ exposure to SBS. As the Commission noted in the Proposing Release, it expects a lag between the time when an SBS is executed (*i.e.*, the point at which both counterparties become irrevocably bound to a transaction under applicable law), and when the transaction is confirmed (*i.e.*, when a trade acknowledgment of the transaction is provided and verified).<sup>66</sup> Requiring prompt provision of trade acknowledgments also should help SBS Entities to submit timely and accurate reports with respect to those transactions to SBS data repositories. The Commission’s proposed rule was intended to promote the goal of promptly providing trade acknowledgments, though it tempered that objective due to the Commission’s recognition that it might be difficult to achieve that goal, particularly for customized agreements that are not executed or processed electronically.<sup>67</sup>

#### 2. Comments

Four commenters discussed the timing requirements of proposed Rule 15Fi-1(c).<sup>68</sup> Two comments from the same commenter generally questioned the reason for requiring confirmation in 24 hours or less and expressed concern

manually, might be in this category. See Proposing Release, 76 FR at 3863 and n.28.

<sup>64</sup> See Proposing Release, 76 FR at 3863.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> ISDA I; MarkitSERV; ISDA II; Barnard.

that it could increase systemic risk by forcing market participants to focus on speed rather than accuracy.<sup>69</sup>

One commenter expressed the view that the proposed timing standards are impractical for products where no master confirmation agreement or similar template exists.<sup>70</sup> This commenter also suggested that certain terms of the transaction, such as the counterparty name (if the trade is being allocated by an investment manager) or initial rates, may not be available until after the execution.<sup>71</sup> In addition, this commenter stated that SBS Entities may need more than 24 hours to deliver a trade acknowledgment in cross-border transactions due to business day and time zone differences.<sup>72</sup> Moreover, this commenter maintained that it may not be achievable to send a trade acknowledgment within the proposed time period for a transaction that is neither traded electronically nor processed electronically.<sup>73</sup> The commenter stated that some transactions are heavily negotiated, bespoke in nature, and require protracted post-trade detail work.<sup>74</sup> The commenter also indicated that “complete pre-agreement of terms would require end-users to engage significant legal resources for *all* proposed transactions, as compared to existing practice, which focuses on transactions that have actually been executed.”<sup>75</sup>

One commenter compared the Commission’s proposed rule (which would have allowed SBS Entities 24 hours from execution to issue the trade acknowledgment for transactions that are not electronically processed) with the CFTC’s proposal to require confirmation of non-electronically processed transactions by the end of the day of execution.<sup>76</sup> The commenter suggested that the 24 hour period should be measured only during business days, but expressed doubts that even this time frame could be achieved for all transactions that are not electronically processed.<sup>77</sup>

The commenter also expressed concern that the proposed rule’s timing requirement is inconsistent with the CFTC Rule and those of relevant foreign regulatory authorities.<sup>78</sup> The commenter believes that these differences will impose unnecessary costs on market participants, and may lead to confusion in, and disruption of, the SBS market without yielding commensurate benefits.<sup>79</sup> The commenter noted that the CFTC replaced the proposed time periods for swaps executed or processed electronically in their entirety with a requirement that, subject to a compliance phase-in schedule, all swaps among Swap Entities or between swap dealers, major swap participants, and financial entities be confirmed as soon as technologically practicable, but no later than the end of the first business day following the day of execution.<sup>80</sup>

Further, this commenter suggested that different asset classes, and even different products within an asset class, will require tailoring the confirmation timing requirements, particularly between bespoke transactions and “garden variety” security-based swaps.<sup>81</sup>

One commenter suggested that the Commission provide more guidance on how to interpret the term “promptly” as used in proposed Rule 15Fi–1(c).<sup>82</sup>

Two commenters maintained that the proposed rule may affect the way investment managers conduct their business.<sup>83</sup> One of these commenters asserted that certain terms required to be on a trade acknowledgment may not be known to the transacting counterparties within 24 hours of execution, including the counterparty name (if the trade is being allocated by an investment manager).<sup>84</sup> The commenter explained that investment managers commonly execute a single trade and then allocate positions across their clients and this process may take more than 24 hours.<sup>85</sup> The commenter also stated that the allocation process may require investment managers to receive instructions from their clients.<sup>86</sup> The second commenter explained that the current market practice is for investment managers to enter a transaction at the ‘execution’ level for a certain notional size and price,” and only allocate the transaction to multiple

underlying funds thereafter.<sup>87</sup> Thus, the commenter suggested measuring the time period in which a trade acknowledgment should be sent from the point when the SBS Entity possesses all the information necessary to issue the trade acknowledgment.<sup>88</sup>

### 3. Response to Comments and Final Rule

After considering the comments, the Commission is revising proposed Rule 15Fi–1(c) to provide that an SBS Entity must provide a trade acknowledgment promptly, but in any event by the end of the first business day following the day of execution, and renumbering it as Rule 15Fi–2(b).<sup>89</sup> The requirement that the responsible counterparty promptly provide a trade acknowledgment would help ensure that the counterparties know, and have a record of, the terms of their executed agreement in a timely manner. “Promptly,” in this context, generally should be understood to mean that an SBS Entity should provide a trade acknowledgment as soon as practicable within the period specified in the rule (by the end of the first business day following the day of execution).<sup>90</sup>

The Commission recognizes the commenters that were concerned that 24 hours might not be enough time for all transactions, and has taken those comments into account in providing additional time under the rule as adopted.<sup>91</sup> The additional time permitted under the rule as adopted to provide a trade acknowledgment takes into account that certain transactions may take more time to acknowledge because of the asset class of the transaction or the bespoke nature of the particular transaction. In addition, the additional time permitted under the rule as adopted takes into account the process by which investment managers allocate transactions, and should help to ensure that SBS Entities have adequate time to provide a trade acknowledgment for transactions that occur late in the day. This time period also will provide efficiencies for SBS Entities that are also Swap Entities by allowing the same amount of time as that required by the CFTC rule requiring confirmation of swap transactions.<sup>92</sup> We also note that,

<sup>87</sup> MarkitSERV at 8.

<sup>88</sup> *Id.*

<sup>89</sup> Final Rule 15Fi–2(b).

<sup>90</sup> An SBS Entity generally should not purposefully delay sending trade acknowledgments, for example by programming its systems to delay sending the trade acknowledgments until the end of the allowable time period specified in the rule.

<sup>91</sup> See ISDA I at 3–4; ISDA II at 3; MarkitSERV at 8.

<sup>92</sup> See 17 CFR 23.501(a)(1)–(2). This change thus responds to commenters who requested greater

<sup>69</sup> ISDA I at 3; ISDA II at 3.

<sup>70</sup> ISDA I at 4.

<sup>71</sup> *Id.* at 3.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* at 5.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.* at 6.

<sup>76</sup> MarkitSERV at 8. The final CFTC Rule requires that Swap Entities, as soon as technologically practicable, but in any event by the end of first business day following the day of execution: (i) Confirm a transaction with another Swap Entity, and (ii) provide a trade acknowledgment to a counterparty that is not a Swap Entity. 17 CFR 23.501(a).

<sup>77</sup> MarkitSERV at 8.

<sup>78</sup> ISDA II at 2.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 2–3.

<sup>81</sup> ISDA II at 3.

<sup>82</sup> Barnard at 2.

<sup>83</sup> *Id.* at 4; MarkitSERV at 8.

<sup>84</sup> ISDA I at 3.

<sup>85</sup> ISDA I at 4.

<sup>86</sup> *Id.*



under the final rule, an SBS Entity has at least as much time to provide a trade acknowledgment as it would under one commenter's suggestion that we measure our proposed 24 hour timing requirement only during business days.<sup>93</sup> As compared to the timing requirement of the proposed rule, the final rule's requirement that an SBS Entity provide a trade acknowledgment promptly but no later than the end of the first business day following the day of execution aligns more closely with the timing requirement for confirmation of SBS transactions that have been adopted by certain foreign regulators.<sup>94</sup>

Given this change, the Commission is also defining "day of execution" to mean the calendar day of the counterparty to the security-based swap transaction that ends the latest, provided that if a security-based swap transaction is: (1) Entered into after 4:00 p.m. in the place of a counterparty; or (2) entered into on a day that is not a business day in the place of a counterparty, then such security-based swap transaction shall be deemed to have been entered into by the counterparty on the immediately succeeding business day of that counterparty, and the day of execution shall be determined with reference to such business day. This definition matches that used in the CFTC Rule, except to replace references to "party" in the CFTC rule with "counterparty" in Rule 15Fi-2, and references to "swap" with "security-based swap."<sup>95</sup> For clarity, the Commission is also defining "business day" to mean any day other than a Saturday, Sunday, or a legal holiday.<sup>96</sup> For SBS Entities in the U.S., a "legal holiday" generally would be any U.S. federal holiday. The Commission recognizes that counterparties to the trade may be in different time zones and/or jurisdictions, and that in the absence of Rule 15Fi-1(d), there could be

conformity between the Commission's and the CFTC's rules. See MarkitSERV at 9, ISDA II at 3, 8.

<sup>93</sup> MarkitSERV at 8.

<sup>94</sup> See note 78, *supra*, and accompanying text. See, e.g., Commission Delegated Regulation 149/2013, art. 12(1)-(2), 2013 O.J. (L52) 20-21 (EU) (requiring the documentation of the counterparties' agreement to all the terms of non-centrally cleared OTC derivative contracts as soon as possible and at the latest as follows: (1) If concluded between financial counterparties or certain non-financial counterparties with OTC derivatives portfolios above specified thresholds, by the end of the next business day following the date of execution, and (2) if concluded with a non-financial counterparty with an OTC derivatives portfolio at or below specified thresholds, by the end of the second business day following the date of execution).

<sup>95</sup> 17 CFR 23.501(a)(5)(i).

<sup>96</sup> Final Rule 15Fi-1(a).

confusion about whether "business day" referred to the jurisdiction and time zone of one counterparty or the jurisdiction and time zone of the other counterparty. These definitions help to clarify the obligation to provide a trade acknowledgment in cross-border transactions or those in which the parties have different business days or time zones. These definitions also create consistency with the CFTC Rule.

As noted, the timing requirement in Final Rule 15Fi-2(b) takes into account and should help address the comment suggesting that the Commission adopt different timing requirements for different asset classes of security-based swap transactions and to distinguish between the timing requirements for transactions that are bespoke to greater or lesser degrees.<sup>97</sup> Although the timing requirement is uniform for transactions in any asset class and between standardized and bespoke contracts, the additional time provided should address what we believe is the root of the commenter's concern—that the proposed rule did not provide sufficient time to provide a trade acknowledgment for certain asset classes or for more bespoke transactions. The Commission notes that a uniform timing requirement for trade acknowledgments is consistent with the CFTC Rule, which does not recognize distinctions between different asset classes or whether a swap is standardized when specifying the time allotted for provision of a trade acknowledgment or confirmation. The Commission recognizes that the commenter may desire even more time than that provided in the final rule to provide a trade acknowledgment in bespoke transactions, but does not believe that it is appropriate to provide for a longer period of time. The rule as adopted takes into account the comments requesting a longer period of time than that which we proposed, as well as the objective of the proposed rule to help ensure that the counterparties know, and have a record of, the terms of their executed agreement in a timely manner, and the Commission believes that the time period as adopted is an appropriate approach.

One commenter noted that different investment managers may have different policies for allocating trades to their clients and do so over differing time periods.<sup>98</sup> For example, assume a single investment manager manages several investment funds and has discretionary authority to execute SBS transactions with an SBS Entity on behalf of each of

the funds. Assume further that the SBS Entity knows the universe of funds managed by the investment manager. We understand that common industry practice is that the SBS Entity will execute SBS transactions with the investment manager on behalf of one or more of the funds it manages without requiring the investment manager to disclose at the time of execution the specific funds that will be the counterparties to the transaction. The timing requirement in Final Rule 15Fi-2(b) recognizes that allocations by an investment manager may not occur before or contemporaneous with the execution of the "bunched" order, and thus it allows additional time compared to the proposed rule for an SBS Entity to provide a trade acknowledgment.<sup>99</sup>

In light of these considerations and the time period for providing a trade acknowledgment that is being adopted, the Commission is not modifying the rule, as suggested by one commenter, to measure the time period in which a trade acknowledgment should be sent from the point when the SBS Entity possesses all the information necessary to issue the trade acknowledgment. Generally, the Commission is concerned that, once an execution has occurred, delaying the trade acknowledgment for an indefinite and unknown amount of time could create an unacceptable period of lingering uncertainty about the terms of the transaction. This in turn would extend the period of risk presented by undocumented transactions and would be inconsistent with the objective of the rule to promote timely provision of the trade acknowledgment. With respect to the commenter's specific concerns regarding allocations or the initial rate for a transaction,<sup>100</sup> the Commission believes, as discussed above,<sup>101</sup> that the additional time allowed under Final Rule 15Fi-2(b) for an SBS Entity to provide a trade acknowledgment should provide an appropriate amount of time for an SBS Entity to obtain the information required on a trade acknowledgment that was not available at the time of execution. The timing requirements of the CFTC Rule are substantially similar to the Commission's final rule,<sup>102</sup> and many

<sup>99</sup> The Commission has proposed rules concerning margin requirements and books and record keeping requirements for SBS. To the extent these rules are adopted, an SBS Entity that accepts trades from an agent on behalf of unidentified principals in this manner will need to separately consider its obligations under those rules.

<sup>100</sup> ISDA I at 3.

<sup>101</sup> See notes 98-99, *supra*, and associated text.

<sup>102</sup> See 17 CFR 23.501(a) (requiring that a Swap Entity either confirm its transaction (if it is with a

SBS Entities that will be subject to the final rule are Swap Entities subject to the CFTC Rule. We have considered the commenter's request that we effectively allow an unlimited amount of time to provide a trade acknowledgment if the SBS Entity has not received certain information, such as the allocation or initial rate for a transaction, and we also considered the objectives of the rule to promote timely acknowledgment and verification of transactions. After taking into consideration the comments and the objectives of the rule, we believe, as discussed above, that requiring that SBS Entities provide the trade acknowledgment by the end of the next business day after the day of execution is an appropriate approach that promotes timely acknowledgment and verification of the terms of the transactions. We are not adopting proposed Rule 15Fi-1(c)(2), which would have required that an SBS Entity electronically process transactions if it has the ability to do so. The Commission proposed the requirement to improve the recordkeeping of SBS Entities and further promote the goals of Section 15F(i) of the Exchange Act.<sup>103</sup> However, the Commission believes that requiring electronic processing is not necessary at this time to achieve this objective in light of the Final Rule's timing requirement—which requires prompt acknowledgment of SBS transactions and thus encourages SBS Entities to electronically process transactions to improve their ability to comply with its requirements.

#### D. Form and Content of Trade Acknowledgments

##### 1. Proposed Rule

Paragraph (d) of proposed Rule 15Fi-1 would have required the trade acknowledgments to be provided through any electronic means that provide reasonable assurance of delivery and a record of transmittal. The Commission proposed the electronic delivery requirement to promote the timely provision of trade acknowledgments in accordance with Exchange Act Section 15F(i). The proposed rule was intended to provide flexibility for SBS Entities to determine the specific electronic means by which they will comply.<sup>104</sup>

The Commission noted in particular that SBS Entities may choose to provide

trade acknowledgments through a mutually agreed upon electronic standard, such as a messaging system that uses Financial products Markup Language (commonly known as FpML).<sup>105</sup> The Commission also specifically discussed facsimile transmission or electronic mail as a means of providing trade acknowledgments, particularly when engaging in SBS transactions with counterparties that rarely buy or sell SBS and that consequently do not have the means to receive trade acknowledgments otherwise.<sup>106</sup> The Commission further stated that providing trade acknowledgments exclusively by mail or overnight courier would not satisfy the requirements of the proposed rule.<sup>107</sup>

Paragraph (d) of proposed Rule 15Fi-1 also would have required trade acknowledgments to contain a minimum of 22 items of information, all but one of which were identical to the items that the Commission had proposed that SBS Entities would be required to report to an SBS data repository pursuant to Regulation SBSR.<sup>108</sup>

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> See SBSR Proposing Release, note 31, *supra*. The Commission later adopted Regulation SBSR. See SBSR Adopting Release, note 49, *supra*.

Specifically, proposed Rule 15Fi-1(d) would have required the trade acknowledgment to include terms from proposed Regulation SBSR, including: (1) The asset class; (2) information identifying the SBS instrument and the specific asset(s) or issuer of a security on which the SBS is based; (3) the notional amount and currency; (4) date and time of execution; (5) the effective date; (6) the scheduled termination date; (7) the price; (8) the terms of any fixed or floating rate payments, and the frequency of any payments; (9) whether or not the security-based swap would have been cleared by a clearing agency; (10) an indication if both counterparties are SBS dealers; (11) if the transaction involved an existing SBS, an indication that the transaction did not involve an opportunity to negotiate a material term of the contract, other than the counterparty; (12) an indication if the SBS is customized to the extent that the information provided above does not provide all of the material information necessary to identify the customized SBS or does not contain the data elements necessary to calculate the price; (13) the participant ID of each counterparty; (14) the broker ID, desk ID, and trader ID of the reporting party; (15) the amount(s) and currency(ies) of any up-front payment(s) and a description of the terms and contingencies of the payment streams of each counterparty to the other; (16) the title of any master agreement, or any other agreement governing the transaction, incorporated by reference and the date of any such agreement; (17) the data elements necessary for a person to determine the market value of the transaction; (18) if the SBS will be cleared, the name of the clearing agency; (19) if the SBS is not cleared, whether the exception in Section 3C(g) of the Exchange Act (15 U.S.C. 78c-3(g)) was invoked; (20) if the SBS is not cleared, a description of the settlement terms, including whether the security-based swap is cash-settled or physically settled, and the method for determining

##### 2. Comments

One commenter asserted that product innovation or the bespoke nature of some SBS might cause situations where electronic confirmation cannot be provided, and that the low number of transactions in a specific instrument type might sometimes be insufficient to justify the cost of building the capabilities to electronically confirm transactions.<sup>109</sup> Thus, the commenter indicated that it is not realistic or achievable for the Commission to mandate electronic confirmation of all SBS transactions, and it should be merely encouraged rather than required.<sup>110</sup>

Another commenter suggested that the trade acknowledgment terms should be only the minimum required to evidence agreement to a trade and its material economic terms, and objected to many of the enumerated items in the proposed rule.<sup>111</sup> In particular, the commenter objected to inclusion on the trade acknowledgment of the following specific items:

- Asset class (recommending that the Commission adopt standard taxonomy before requiring this item);
- notional amount (suggesting that the quantity of assets—shares—rather than notional amount should be disclosed for equity derivatives);
- time of the transaction (because execution times are not typically recorded for voice trades);
- counterparty regulatory status (because dealers may not know their counterparty's regulatory status unless it is published by the Commission) and the counterparty's broker, trading and desk identification (noting that there is no analog under Exchange Act Rule 10b-10, and because the information would presumably be maintained as central reference data that could be saved elsewhere);
- an indication that the transaction did not involve an opportunity to negotiate a material term of the contract, if the transaction involved an existing SBS transaction;
- certain information for customized transactions (because inclusion of the elements necessary to calculate prices may go beyond the scope of what can or should be included in a confirmation);

the settlement value; and (21) the execution venue. In addition to these items from proposed Regulation SBSR, proposed Rule 15Fi-1(d)(22) would also have required the trade acknowledgment to include any additional information that is required for the transaction to be cleared by a clearing agency, if the transaction was to be cleared.

<sup>109</sup> *MarketSERV* at 10.

<sup>110</sup> *Id.* at 2 and 10.

<sup>111</sup> ISDA I at 6.

Swap Entity) or provide a trade acknowledgment for the transaction (if it with counterparty that is not a Swap Entity) as soon as technologically practicable, but in any event by the end of first business day following the day of execution.

<sup>103</sup> See Proposing Release, 76 FR at 3863.

<sup>104</sup> See *id.* at 3864.

- a description of the payment streams (because contingent payment streams may be elaborate and can be located in other documents);
- the data elements necessary for the counterparty to determine the market value (because this information may also go beyond the scope of what can or should be included in a confirmation);
- venue (because it is unclear whether this means trading venue); and
- clearing-required information (asserting that it is unnecessary to include clearing agency instructions on the confirmation).<sup>112</sup>

The commenter also urged the Commission to reconsider requiring the trade acknowledgment to include all the data elements necessary to determine the value of the security-based swap.<sup>113</sup> The commenter stated that valuation procedures vary from party to party, and, to the extent that they must be agreed upon, they will be heavily negotiated. The commenter said that requiring the results of the negotiations to be reflected in the trade acknowledgment would slow down the confirmation process.<sup>114</sup>

One commenter also objected to the proposed rule diverging substantially from the CFTC Rule, which requires parties to memorialize the agreement of the counterparties to all the terms of a swap transaction without identifying specific items to be listed on the confirmation.<sup>115</sup> This commenter also requested that the Commission's rule allow for documentation to differ between different asset classes.<sup>116</sup>

One commenter suggested that "the record trail created by the verification process (*i.e.*, the confirmation) should constitute the best evidence that the counterparties . . . agree to the terms and binding nature of the trade."<sup>117</sup> This commenter indicated that the current practice in the security-based swap market is for counterparties to execute a transaction by agreeing to the main economic terms of the transaction (*e.g.*, as to pricing and notional size) and agreeing to other economic details only when they differ from the accepted market practice or are specific to the terms of the counterparty relationship (*e.g.*, master agreement reference or credit terms).<sup>118</sup> The commenter explained that the process of adding additional information to the transaction record to create a complete

documentation of the transaction is referred to as "trade enrichment," and that trade enrichment may happen through a variety of processes, including trade capture systems or automated confirmation services.<sup>119</sup> The commenter also suggests that the definition of "processed electronically" should include electronic communication as a required component.<sup>120</sup>

### 3. Response to Comments and Final Rule

The Commission is adopting the requirement to provide a trade acknowledgment through any electronic means that provide reasonable assurance of delivery and a record of transmittal as proposed in Rule 15Fi-1(d), but is re-designating it as Rule 15Fi-2(c).<sup>121</sup> The Commission acknowledges the comment that it should allow SBS Entities to deliver trade acknowledgments in certain instances on paper rather than electronically,<sup>122</sup> but the Commission believes that requiring electronic delivery of trade acknowledgments will promote the objectives of Exchange Act Section 15F(i)(1) for timely and accurate confirmation and documentation of security-based swaps. Specifically, the electronic delivery of trade acknowledgments will result in SBS counterparties receiving trade acknowledgments in a timelier manner, which will enable them to review the terms of their transactions more quickly to either verify the transactions or dispute the terms. This in turn should help to reduce operational risk by decreasing the amount of time within which a counterparty may recognize and work to resolve any potential discrepancies in the trade documentation. The Commission also understands that electronic confirmation is the norm for SBS transactions.<sup>123</sup> The Commission does not, however, specify the means of electronic delivery, so SBS Entities may rely on any electronic means, such as email systems, to comply with the rule's requirements rather than acquiring or building new computer systems solely to provide trade acknowledgments. Thus, taking into consideration the potential costs of electronic trade acknowledgments and the expected benefits, the Commission believes that it

is appropriate to require electronic delivery of trade acknowledgments. The Commission acknowledges the comment that asserts that it might not be possible to provide an electronic confirmation in all cases.<sup>124</sup> However, the rule as adopted does not require any particular means of electronic delivery; for example, an SBS Entity could send an email with a PDF attachment as a trade acknowledgment to a counterparty. Thus, given the flexibility provided by the rule to provide an electronic confirmation, the Commission believes it is appropriate to require SBS Entities to provide an electronic trade acknowledgment by the end of the next business day after the day of execution.

After careful consideration of the comments, the Commission is revising proposed Rule 15Fi-1(d), now re-designated as Final Rule 15Fi-2(c), to require an SBS Entity to disclose all the terms of the security-based swap transaction, rather than certain enumerated items.<sup>125</sup> The Commission agrees with the commenter that maintained that the confirmation should constitute the best record of the transaction so as to help SBS counterparties have a record that clearly identifies their rights and obligations under the SBS, and thus is requiring that the trade acknowledgment (which forms the basis of the confirmation) include all the terms of the transaction. Final Rule 15Fi-2(c) also responds to objections to the required disclosure of certain listed data requirements of proposed Regulation SBSR, such as the participant ID of each counterparty, the broker ID, the desk ID, and the trader ID, which are not terms of the transaction and may not reflect the data that is most relevant to counterparties. Further, by not enumerating the content requirements of the trade acknowledgment, Final Rule 15Fi-2(c) also allows for flexibility for counterparties with respect to the information provided for different SBS in different asset classes. The requirement to report all the terms of the SBS transaction implicitly accepts that if the terms of SBS in different classes vary, only the terms relevant to the specific asset class of the transaction being acknowledged must be included

<sup>112</sup> *Id.* at 6-7.

<sup>113</sup> *Id.* at 4.

<sup>114</sup> *Id.*

<sup>115</sup> ISDA II at 3; *see also* CFTC Rule, 17 CFR 23.501 and CFTC Adopting Release, 77 FR 55901.

<sup>116</sup> ISDA I at 2.

<sup>117</sup> MarkitSERV at 1.

<sup>118</sup> *Id.* at 2.

<sup>119</sup> *Id.*

<sup>120</sup> *Id.*

<sup>121</sup> The final rule also contains a technical correction changing the word "in" to "by."

<sup>122</sup> *See* notes 109 and 110, *supra*, and accompanying text.

<sup>123</sup> *See* the discussion of current trade confirmation practices in Section VII.B.3 below.

<sup>124</sup> *See supra* notes 109 and 110.

<sup>125</sup> We emphasize that Rule 15Fi-2 as adopted does not limit any disclosure obligations that an SBS Entity may have under other applicable federal securities laws, rules or regulations, including the anti-fraud provisions of the federal securities laws.

on the trade acknowledgment under Final Rule 15Fi-2.<sup>126</sup>

This change also responds to commenters who advocated for greater consistency between the Commission's rules and those of the CFTC.<sup>127</sup> The Commission believes that commonality between the trade acknowledgment and verification standards for swaps and SBS will facilitate compliance for SBS Entities that are also Swap Entities and thus are already complying with the CFTC's rule.

Further, the Commission acknowledges that an SBS Entity may want to comply with the Final Rule's content requirements by incorporating documents by reference into the trade acknowledgment. For example, the Commission understands that an SBS Entity may want to include by reference in the trade acknowledgment certain standard provisions in its master agreement with its counterparty that will control each SBS transaction executed with that counterparty. An SBS Entity that chooses to utilize this method should ensure that it complies with any applicable rules regarding its maintenance of the documents incorporated by reference<sup>128</sup> and that the trade acknowledgment reflects the actual terms of each SBS transaction.<sup>129</sup>

The Commission is not adopting any changes to the proposed rule following one commenter's suggestion that "processed electronically" be defined to include electronic communication as a required component. The Commission proposed the term "processed electronically" to define a group of SBS transactions for which the proposed rule would have required SBS Entities to provide a trade acknowledgment within 15 or 30 minutes of the transaction's execution. The proposed rule would have required SBS Entities to provide a trade acknowledgment for certain other transactions no later than 24 hours from

<sup>126</sup> The change to require all of the terms of the transaction also responds to the commenter who opposed requiring the trade acknowledgment to include all the data elements necessary to determine the value of the security-based swap, as Final Rule 15Fi-2 does not state that an SBS Entity must include the data elements necessary to determine the value of the security-based swap on the trade acknowledgment.

<sup>127</sup> MarkitSERV at 9; ISDA II at 3, 8.

<sup>128</sup> The Commission has proposed rules governing books and recordkeeping requirements for SBS Entities. See Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25193 (May 2, 2014) ("SBS Books and Records Proposing Release").

<sup>129</sup> This position is consistent with the CFTC's interpretive guidance for the confirmation of swap transactions. See CFTC Adopting Release, 77 FR 55903 at 55919.

the time of execution. The Commission is not adopting a definition of "processed electronically," and the final rule does not use this term. The final rule instead sets a uniform time during which SBS Entities must provide a trade acknowledgment.

#### E. Trade Verification

##### 1. Proposed Rule

As part of the trade verification process, paragraph (e)(1) of proposed Rule 15Fi-1 would have required an SBS Entity to establish, maintain, and enforce written policies and procedures that are reasonably designed to obtain prompt verification of trade acknowledgments that it provides pursuant to the proposed rule. The Commission stated that it preliminarily believed that this requirement would help to minimize the number of unverified trade acknowledgments, and thereby reduce the operational risk and uncertainty associated with unverified SBS transactions.<sup>130</sup>

Proposed Rule 15Fi-1(a)(13) would have defined "verification" as the process by which a trade acknowledgment has been manually, electronically, or by some other legally equivalent means, signed by the receiving counterparty.<sup>131</sup> The Commission noted in proposing the rule that verifying trades may be done through a process in which the counterparty affirms the transaction terms after reviewing a trade acknowledgment sent by the first counterparty.<sup>132</sup> The counterparty may also dispute the terms of the transaction (often referred to as a "DK" of the transaction, short for "don't know"). Verifying or disputing the transaction may be done by various methods, including where the first counterparty transmits a trade acknowledgment to its counterparty, after which the counterparty—electronically, manually, or by some other legally equivalent method—either signs and returns the trade acknowledgment to verify the transaction, or notifies the counterparty that it rejects the terms. By promoting prompt verification, the proposed rule was intended to minimize the operational risk and uncertainty associated with SBS transactions for which trade acknowledgments have not been verified.

For SBS transactions that are not subject to clearing, paragraph (e)(1) of the proposed rule would have required SBS Entities to establish their own trade verification processes. For example, an

SBS Entity could establish, maintain, and enforce policies and procedures under which it will only deal with a counterparty that agrees to timely review any trade acknowledgment to ensure that it accurately describes their agreed upon transaction, and sign and return the trade acknowledgment as evidence of the verification. SBS Entities' policies and procedures for verification could also include using a third-party matching service.

Proposed Rule 15Fi-1(e)(2) would have provided that: in any SBS transaction to be cleared through a clearing agency, an SBS Entity must comply with the verification process prescribed by the clearing agency;<sup>133</sup> and that such compliance would have satisfied the verification requirements of subparagraph (e)(1) with respect to the transaction.<sup>134</sup>

Paragraph (e)(3) of the proposed rule would have required SBS Entities to promptly verify the accuracy of, or dispute with their counterparties, the terms of trade acknowledgments they receive pursuant to the proposed rule. This requirement was intended to reduce the incidence of unverified SBS transactions, thereby reducing the operational risk for SBS Entities.<sup>135</sup>

##### 2. Comments

One commenter recommended applying time limitations to verifying the transaction in addition to the proposed time limitation for sending the trade acknowledgment.<sup>136</sup> The commenter suggested that if the trade acknowledgment is executed electronically and processed electronically, the trade acknowledgment should be sent within 15 minutes, and the verification provided within 15 minutes of the trade acknowledgment being sent. Similarly, trades that must be acknowledged within 30 minutes should have to be verified within 30 minutes of the trade

<sup>133</sup> The Commission noted in the Proposing Release that it expected that clearing agencies would adopt rules to obtain the signature of a counterparty on a trade acknowledgment as part of their verification procedures. In electronically processed transactions, the clearing agency could obtain counterparties' signatures electronically or by other means. See Proposing Release, 76 FR at 3866.

<sup>134</sup> As also noted in the Proposing Release, each counterparty could submit the SBS terms to an agreed-upon matching service operated by a registered clearing agency. The matching service would then compare the submitted transaction terms. If the submitted SBS terms agreed, the transaction would be verified; otherwise, the matching service would notify the counterparties of the discrepancies, and the counterparties would have the opportunity to resolve them. *Id.* at n.39.

<sup>135</sup> See proposed Rule 15Fi-1(e)(3); see also Proposing Release, 76 FR at 3867.

<sup>136</sup> MarkitSERV at 9.

<sup>130</sup> Proposing Release, 76 FR at 3866.

<sup>131</sup> See proposed Rule 15Fi-1(a)(13).

<sup>132</sup> Proposing Release, 76 FR at 3866.

acknowledgment being sent, and trades acknowledged within 24 hours of execution should have to be verified within 24 hours of receiving the trade acknowledgment.<sup>137</sup> This commenter also supported the CFTC's proposed requirement that Swap Entities have written policies and procedures reasonably designed to ensure confirmation with non-financial entities not later than the next business day following the day the swap transaction is executed, and the commenter suggested that Commission harmonize its requirement with the CFTC's requirement.<sup>138</sup>

One commenter stated its view that the proposed trade acknowledgment and verification process does not account for competing conventions in some transactions.<sup>139</sup> The commenter stated that, for some products, an acknowledgment or notice is sent for certain "'mid-life' trade events" without the expectation of verification.<sup>140</sup> In other transactions, both counterparties may issue a trade acknowledgment to their counterparty, but will respond only if there are discrepancies.<sup>141</sup> The commenter noted that counterparties may also rely on "negative affirmation," which relies only on one-way confirmations unless the terms are being disputed.<sup>142</sup>

One commenter supported what it viewed as a requirement in proposed Rule 15Fi-1(e) that the counterparties "consent to the binding nature of the verification process (*i.e.*, produce a legally binding confirmation)", and made the observation that this is consistent with the CFTC Rule.<sup>143</sup>

### 3. Response to Comments and Final Rule

The Commission is adopting proposed Rule 15Fi-1(e) with some modifications below, and the proposed rule as described below, and is re-

designating it as Final Rule 15Fi-2(d). The Commission believes that requiring SBS Entities to establish, maintain, and enforce written policies and procedures reasonably designed to obtain prompt verification of security-based swap transactions will encourage prompt verification of trades with SBS Entities and thereby will advance the objective of Exchange Act Section 15(F)(i) to promote timely and accurate confirmation and documentation of security-based swaps. Final Rule 15Fi-2(d)(2) will further promote this objective by requiring an SBS Entity to promptly verify the accuracy of, or otherwise dispute with its counterparty, the terms of a trade acknowledgment it receives pursuant to Final Rule 15Fi-2(a).<sup>144</sup>

The Commission is not adopting, as suggested by a commenter, a maximum amount of time for an SBS Entity to verify a trade acknowledgment that it receives. The Commission believes that it is appropriate for the final rule to specify a maximum amount of time for an SBS Entity to provide a trade acknowledgment because the trade acknowledgment serves the important roles of notifying the recipient that (1) its counterparty believes it has executed an SBS transaction and (2) the purported terms of that transaction. The recipient then has the opportunity to review the trade acknowledgment to determine if the trade acknowledgment accurately reflects its agreement with the counterparty. If the recipient agrees that the trade acknowledgment is accurate, the recipient could be expected as an ordinary business practice to verify the transaction promptly. If the recipient believes the trade acknowledgment is inaccurate, the recipient may need additional time to resolve its dispute about the purported terms. Placing a specific time period on the requirement to verify a transaction could mean that, even in the case of good faith disputes about the terms of a trade acknowledgment, a trade acknowledgment recipient would be made to verify, and effectively agree to, incorrect terms on a trade acknowledgment solely to avoid violating the rule even though both counterparties might benefit from using more time to resolve the dispute. The trade acknowledgment's timing requirement thus promotes timely documentation of the transaction, and the flexibility afforded by the final rule's

requirements on verification help to safeguard the accuracy of that documentation.

The Commission also is not modifying the proposed rule in response to the commenter's concern that it does not account for differing conventions with respect to "'mid-life' trade events." It is not clear whether the concern is with respect to certain corporate actions (*e.g.*, mergers, dividends, stock splits, or bankruptcies) that may affect the securities underlying the SBS, or with respect to modifications to the SBS agreed by the counterparties after execution (*e.g.*, novations or assignments, unwinds, terminations, or other amendments or modifications to the SBS transaction). In our view, such corporate actions do not require a trade acknowledgment under the rule because these actions are not themselves a purchase or a sale of an SBS.<sup>145</sup> Thus, although counterparties may choose to issue some record acknowledging these actions according to whatever conventions the counterparties prefer, it is not required by Final Rule 15Fi-2. A novation, assignment, unwind or termination (prior to the scheduled maturity date) of an existing SBS would be a purchase or sale, and thus require a trade acknowledgment under Final Rule 15Fi-2.<sup>146</sup> This is consistent with

<sup>145</sup> However, a modification to an SBS that was made by the counterparties as a result of a corporate action with respect to a security underlying the SBS may be a purchase or sale of an SBS under the definition of "purchase" or "sale" in Exchange Act Sections 3(a)(13) and (14).

<sup>146</sup> Other amendments or modifications to an existing SBS may also be purchases or sales if they meet the definitions for a "purchase" or "sale" in Exchange Act Sections 3(a)(13) and (14). The Commission has previously noted that if the material terms of an SBS are amended or modified during its life based on an exercise of discretion and not through predetermined criteria or a predetermined self-executing formula, the Commission views the amended or modified SBS as a new SBS. See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release No. 67453, 77 FR 48207 at 48286 (Aug. 13, 2012). The Commission considers such amendments or modifications to an SBS based on the exercise of discretion to result in the purchase and sale of a new SBS. The Commission has also previously noted that its business conduct rules generally will not apply to amendments or modifications to a pre-existing SBS unless the amendment or modification results in a new SBS. See Business Conduct Adopting Release, 81 FR at 29969. For example, the Commission has stated that the business conduct rules generally will not apply to either a full or partial termination of a pre-existing SBS. *Id.* The trade acknowledgment rule, however, applies to any transaction that is a purchase or sale of an SBS, even if the amendment or modification based on the exercise of discretion does not result in a new SBS. Thus, for example, an SBS Entity must provide a trade acknowledgment for a full termination (if prior to the scheduled maturity date) or a partial termination.

<sup>137</sup> *Id.*

<sup>138</sup> *Id.* The CFTC Rule as adopted requires that a Swap Entity establish, maintain, and follow written policies and procedures reasonably designed to ensure that it executes a confirmation for each swap transaction with a Swap Entity or a financial entity no later than the end of the first business day following the day of execution, and a requirement that a Swap Entity establish, maintain, and follow written policies and procedures reasonably designed to ensure that it executes a confirmation for each swap transaction that it enters with any other entity not later than the end of the second business day following the day of execution. See 17 CFR 23.501(a)(3).

<sup>139</sup> ISDA I at 8.

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> *Id.* at 5.

<sup>143</sup> MarkitSERV at 4-5. We note that nothing in the rule as proposed or adopted requires parties to "consent to the binding nature of the trade verification process."

<sup>144</sup> "Promptly," in this context, generally should be understood to mean that an SBS Entity should verify or otherwise dispute with its counterparty, the terms of a trade acknowledgment that it receives as soon as practicable. See note 90, *supra*, and the related text.

the objective of the rules, to help ensure that counterparties have a complete understanding of their agreement and a record of its terms in a timely manner.

The Commission is not adopting the commenter's suggested requirement for SBS Entities to have written policies and procedures reasonably designed to ensure confirmation with non-SBS Entities by the next business day after the swap transaction is executed.<sup>147</sup> The Commission expects that SBS Entities may enter transactions with unregistered counterparties with varying levels of sophistication and different compliance procedures, which may require different amounts of time to respond to trade acknowledgments. The Commission notes, however, that policies and procedures reasonably designed to ensure prompt verification of a transaction may include policies and procedures under which the SBS Entity relies on its counterparty's negative affirmation to the terms of a trade acknowledgment. The Commission understands that Swap Entities commonly use negative affirmation to reduce the legal uncertainty that might otherwise occur if a counterparty were to fail to verify a trade acknowledgment in a timely manner. The Commission generally would consider negative affirmation policies and procedures reasonable if they require that the SBS Entity's counterparty agree to be bound by negative affirmation before or at the time of execution of the SBS transaction and if the policies and procedures provide adequate time after the counterparty receives the trade acknowledgment to dispute its terms or otherwise respond to the trade acknowledgment. Further, the policies and procedures generally should require the SBS Entity to document its counterparty's agreement to rely on negative affirmation.

After further consideration, the Commission has determined not to adopt Rule 15Fi-1(e)(2) as proposed, which would have: (1) Required, in any transaction to be cleared by a clearing agency, an SBS Entity to comply with the verification process prescribed by the clearing agency; and (2) provided that compliance with the clearing agency's verification process in a transaction to be cleared would satisfy the SBS Entity's requirement to establish, maintain, and enforce written policies and procedures that are reasonably designed to obtain prompt verification of the transaction. Instead, as discussed in Section II.G. below, the Commission is adopting an exception

from Rule 15Fi-2 for SBS transactions submitted to, and accepted for, clearing at a registered clearing agency, which exception essentially would address more broadly the application of the proposed verification requirements to SBS transactions to be cleared.

Finally, we are adopting as proposed Rule 15Fi-1(e)(3), but re-designating it as Final Rule 15Fi-2(d)(2).

#### F. Exception for Clearing Transactions

Proposed Rule 15Fi-1(b) generally would have required an SBS Entity to provide a trade acknowledgment to its counterparty whenever it purchases or sells an SBS. "Purchase" is defined in the Exchange Act to include "any contract to buy, purchase, or otherwise acquire."<sup>148</sup> Sale is defined under the Exchange Act as "any contract to sell or otherwise dispose of."<sup>149</sup> "Purchase" and "sale" are each further defined, for purposes of an SBS, to include "the execution, termination (prior to its scheduled maturity date), assignment, exchange or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require."<sup>150</sup> Proposed Rule 15Fi-1(b) did not differentiate between cleared SBS and uncleared SBS. Accordingly, if an SBS Entity purchased a security-based swap from or sold a security-based swap to a clearing agency as part of a clearing transaction, proposed Rule 15Fi-1(b) would have required the SBS Entity to provide a trade acknowledgment to the clearing agency.

In the Proposing Release, the Commission asked whether clearing agencies should be permitted to provide trade acknowledgments on behalf of SBS Entities in transactions where the clearing agency was not responsible for clearing the transaction through a matching process, and if so, under what conditions.<sup>151</sup> One commenter suggested that an SBS Entity should be able to satisfy the rule's requirements merely by clearing the swap through a derivatives clearing organization, among other means.<sup>152</sup>

Upon consideration of the comment, for the reasons discussed below, the Commission believes that it is unnecessary to require an SBS Entity to comply with the trade acknowledgment and verification provisions of Rule 15Fi-2 when it is a counterparty to an SBS transaction with a clearing agency. Thus, we are providing in Rule

15Fi-2(e) as adopted that a security-based swap dealer or major security-based swap participant is excepted from the requirements of Rule 15Fi-2 with respect to any clearing transaction. For these purposes, Final Rule 15Fi-1(c) defines "clearing transaction" as a security-based swap that has a clearing agency as a direct counterparty,<sup>153</sup> and "clearing agency" as a clearing agency as defined in Section 3(a)(23) of the Exchange Act that is registered pursuant to Section 17A of the Exchange Act and provides central counterparty services for SBS transactions.

In the agency model of clearing which predominates in the United States, clearing transactions are new transactions created to replace a bilateral SBS transaction that was submitted to, and has been accepted for clearing by, a registered clearing agency, in which the clearing agency becomes the new direct counterparty to each of the counterparties of the original bilateral transaction. Therefore, these clearing transactions (known as the "beta" and "gamma") effectively mirror the original bilateral transaction (known as the "alpha") that was extinguished in the process of acceptance for clearing.<sup>154</sup> Because the final rules define "clearing transaction" to include only a transaction where the clearing agency is a counterparty to a trade, *e.g.*, beta and gamma transactions, the exception in Final Rule &15Fi-2(e) does not apply to the initial bilateral

<sup>153</sup> This is the same meaning as in Exchange Act Rule 900(g). Clearing transactions thus include, for example, any security-based swaps that arise if a registered clearing agency accepts a security-based swap for clearing, as well as any security-based swaps that arise as part of a clearing agency's internal processes, such as security-based swaps used to establish prices for cleared products and security-based swaps that result from netting other clearing transactions of the same product in the same account into an open position. See SBSR Adopting Release, *supra* note 49, 80 FR at 14599.

<sup>154</sup> If both direct counterparties to the alpha transaction are members of the clearing agency, the direct counterparties would submit the transaction to the clearing agency directly and the resulting beta transaction would be between the clearing agency and one clearing member, and the gamma transaction would be between the clearing agency and the other clearing member. The Commission understands, however, that if the direct counterparties to the alpha transaction are a clearing member and a non-clearing member (a "customer"), the customer's side of the trade would be submitted for clearing by a clearing member acting on behalf of the customer. When the clearing agency accepts the alpha transaction for clearing, one of the resulting transactions—in this case, assume the beta transaction—would be between the clearing agency and the customer, with the customer's clearing member acting as guarantor for the customer's trade. The other resulting transaction—the gamma transaction—would be between the clearing agency and the clearing member that was a direct counterparty to the alpha transaction. See SBSR Adopting Release, *supra* note 49, 80 FR 14563 at n. 292.

<sup>148</sup> Exchange Act Section 3(a)(13).

<sup>149</sup> Exchange Act Section 3(a)(14).

<sup>150</sup> Exchange Act Sections 3(a)(13) and (14).

<sup>151</sup> Proposing Release, 76 FR at 3863.

<sup>152</sup> ISDA I at 5.

<sup>147</sup> *Id.*

transaction, *i.e.*, the alpha transaction.<sup>155</sup> In the principal model, a clearing member would clear a security-based swap for a customer by becoming a direct counterparty to a transaction with the customer, and then would become a counterparty to an offsetting transaction with the clearing agency.<sup>156</sup> Thus, the transaction between the clearing member and the clearing agency would be a clearing transaction for purposes of this rule.

In each of the models discussed above, when the CCP is a counterparty to a transaction, the Commission observes that the rules, procedures, and processes of registered clearing agencies that provide central counterparty services for SBSs<sup>157</sup> are generally designed to ensure that the terms of SBS transactions submitted for clearing have been matched and confirmed prior to or at the same time the transaction is accepted by the registered clearing agency for clearing.<sup>158</sup> Thus, the Commission believes that it would be unnecessary and duplicative to require SBS Entities to comply with the requirements of Rule 15Fi-2 for clearing transactions, as it would result in essentially two processes, those of the CCP and those under the rule, to acknowledge and verify the same transaction. Therefore, paragraph (e) of Final Rule 15Fi-2 excepts an SBS Entity from the requirements of Rule 15Fi-2 with respect to clearing transactions.<sup>159</sup>

The Commission proposed to define “clearing agency” as “a clearing agency registered pursuant to Section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1),”<sup>160</sup> but has adopted a

final definition that differs from the proposed definition in two ways. First, the exception in the final rule is intended only for transactions with a clearing agency that provides services that would bring the person within the statutory definition of clearing agency.<sup>161</sup> Thus, for clarity, the final rule’s definition of “clearing agency” is limited to a clearing agency as that term is defined in Section 3(a)(23) of the Exchange Act. Second, the final definition of clearing agency is further limited to a registered clearing agency that provides central counterparty services for SBS transactions. As discussed above, the Commission observes, through its ability to approve the rules and procedures of registered clearing agencies, and its ability to inspect the processes and operations of registered clearing agencies, that the rules, procedures, and processes of registered clearing agencies that provide central counterparty services for SBSs are generally designed so that the terms of SBS transactions submitted for clearing have been matched and confirmed prior to or at the same time the transaction is accepted by the registered clearing agency for clearing. Thus, the Commission is satisfied that registered clearing agencies that provide central counterparty services for SBSs have rules, procedures, and processes that will serve the purpose of the trade acknowledgment rule by providing the parties to the transaction with a record of their transaction. However, the Commission does not make this same observation about the rules, procedures, and processes of clearing agencies that are not registered and do not provide central counterparty services for SBS transactions, and thus it is not extending the exception to clearing agencies that are not registered or that

do not provide central counterparty services for SBSs.

#### *G. Exception for Transactions Executed on a Security-Based Swap Execution Facility or National Securities Exchange or Accepted for Clearing by a Clearing Agency*

The trade acknowledgment and verification requirements in proposed Rules 15Fi-1(b) and (e) generally did not distinguish between transactions executed in the over-the-counter market or transactions executed on a security-based swap execution facility or a national securities exchange. Proposed Rule 15Fi-1(b) also did not distinguish between transactions that would be submitted for clearing at a clearing agency, and those that are not.<sup>162</sup> Proposed Rule 15Fi-1(e)(2) would have addressed SBS transactions to be cleared by a clearing agency, by: (1) Requiring, in any transaction to be cleared by a clearing agency, an SBS Entity to comply with the verification process prescribed by the clearing agency; and (2) providing that compliance with the clearing agency’s verification process in a transaction to be cleared would satisfy the SBS Entity’s requirement to establish, maintain, and enforce written policies and procedures that are reasonably designed to obtain prompt verification of the transaction.

The Commission solicited comment on whether persons such as security-based swap execution facilities should be permitted to provide trade acknowledgments on behalf of SBS Entities.<sup>163</sup> Commenters disagreed on the trade acknowledgment requirements for transactions executed on an execution facility or cleared at a clearing agency. One commenter supported a rule that would be satisfied by executing an SBS on a swap execution facility or on a designated contract market, or by clearing the swap through a derivatives clearing organization.<sup>164</sup> The commenter noted that this approach was consistent with the CFTC’s proposed rule.<sup>165</sup> Another commenter

<sup>155</sup> The application of an exception from the trade acknowledgment and verification requirements for bilateral trades that are submitted to clearing is discussed further in Sections G.2 and G.3 below.

<sup>156</sup> See SBSR Adopting Release, *supra* note 49, 80 FR 14563 at n. 293.

<sup>157</sup> There are currently two clearing agencies registered with the Commission that provide central counterparty services for SBS transactions. The two clearing agencies are ICE Clear Credit LLC and ICE Clear Europe Limited.

<sup>158</sup> See, e.g., ICE Clear Credit LLC Clearing Rule 305 (requiring that participants file with ICE Clear Credit LLC each business day confirmations covering trades made during the day that include certain information about the trade, and providing that, for authorized trade execution/processing platforms or other electronic systems that submit matched trades, the requirement that participants file a confirmation is satisfied by confirming reports that are automatically generated by the platform) and Rule 306 (providing that when a trade between two participants is submitted for clearing, if the trade confirmations submitted by the two participants do not match in all material respects, ICE Clear Credit LLC may reject the trade); see also, ICE Clear Europe Limited CDS Procedures, Section 4.4(c) and more generally the provisions included in Section 4 of the ICE Clear Europe Limited CDS Procedures.

<sup>159</sup> Final Rule 15Fi-2(e).

<sup>160</sup> See proposed Rule 15Fi-1(a)(3).

<sup>161</sup> Exchange Act Section 3(a)(23)(A) generally defines a clearing agency as “any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities. Such term also means any person, such as a securities depository, who (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates.” Exchange Act Section 3(a)(23)(B) excepts certain persons from the definition of “clearing agency.”

<sup>162</sup> Proposed Rule 15Fi-1(a) did, however, propose an exception related to the use of the matching services of a clearing agency, which is discussed separately in Section II.B.1 above.

<sup>163</sup> Proposing Release, 76 FR 3862-3.

<sup>164</sup> ISDA I at 5.

<sup>165</sup> *Id.* The CFTC Rule as adopted provides that any swap transaction executed on a swap execution facility or designated contract market shall be deemed to satisfy the requirements of the rule, provided that the rules of the swap execution facility or designated contract market establish that confirmation of all terms of the transaction shall take place at the same time as execution. 17 CFR 23.501(a)(4)(i). Furthermore, any swap transaction submitted for clearing by a derivatives clearing

expressed concern that an execution facility would not typically have all of the data required to bilaterally confirm trades, either because it supports trading for standardized transactions, where for example common terms such as payment frequency are assumed at execution, or because it does not hold bilaterally specific terms, such as master confirmation agreement type and date.<sup>166</sup> In either case, the commenter stated that these terms would be added during the enrichment process, with the full transaction details later agreed through an affirmation or matching process.<sup>167</sup>

For the reasons discussed below and in response to comments, the Commission has determined to adopt an exception from the trade acknowledgment and verification requirements of Final Rule 15Fi-2 for transactions executed on registered SBSEFs and registered national securities exchanges, and for transactions submitted to, and accepted for, clearing at a registered clearing agency, subject to certain conditions. Specifically, Rule 15Fi-2(f)(1) as adopted provides that an SBS Entity is excepted from the requirements of the rule with respect to any SBS transaction executed on an SBSEF or national securities exchange, provided that the rules, procedures or processes of the SBSEF or national securities exchange provide for the acknowledgment and verification of all terms of the SBS transaction no later than the time required by paragraphs (b) and (d)(2) of Rule 15Fi-2. Rule 15Fi-2(f)(2) as adopted provides that an SBS Entity is excepted from the requirements of the rule with respect to any SBS transaction that is submitted for clearing to a clearing agency, provided that: (i) The SBS transaction is submitted for clearing as soon as technologically practicable, but in any event no later

organization are deemed to satisfy the requirements of the rule, provided that: (A) The swap transaction is submitted for clearing as soon as technologically practicable, but in any event no later than the times established for confirmation under the rule, and (B) confirmation of all terms of the transaction takes place at the same time as the swap transaction is accepted for clearing pursuant to the rules of the derivatives clearing organization. 17 CFR 23.501(a)(4)(ii). The CFTC Rule also requires a swap dealer or major swap participant to execute a confirmation for a swap transaction as soon as technologically practicable, but in any event no later than the times established for confirmation under the rule as if such swap transaction were executed at the time the swap dealer or major swap participant receives notice that a swap transaction has not been confirmed by a swap execution facility or a designated contract market, or accepted for clearing by a derivatives clearing organization. 17 CFR 23.501(a)(4)(iii).

<sup>166</sup> MarkitSERV at 5.

<sup>167</sup> *Id.*

than the time established for providing a trade acknowledgment under paragraph (b) of the rule; and (ii) the rules, procedures or processes of the clearing agency provide for the acknowledgment and verification<sup>168</sup> of all terms of the security-based swap transaction prior to or at the same time that the security-based swap transaction is accepted for clearing. Finally, Rule 15Fi-2(f)(3) as adopted provides that if an SBS Entity receives notice that an SBS transaction has not been acknowledged and verified pursuant to the rules, procedures or processes of an SBSEF or a national securities exchange, or accepted for clearing by a clearing agency (*e.g.*, if an alpha trade is not accepted for clearing), the SBS Entity shall comply with the requirements of the rule with respect to such SBS transaction as if such SBS transaction were executed at the time the SBS Entity receives such notice.

#### 1. Exception for Transactions Executed on a Security-Based Swap Execution Facility or National Securities Exchange

As discussed above, the trade acknowledgment and verification rules being adopted today are designed to provide in a timely manner a definitive record of the contract terms to which the counterparties have agreed, thus providing legal certainty about the terms of their agreement in case those terms are later disputed, and serving to reduce operational risk. The Commission understands that there are existing execution facilities that, in connection with facilitating the execution of SBS transactions on their platform also provide a mechanism that obtains the agreement of the counterparties to the terms of the executed SBS transaction. As suggested by a commenter,<sup>169</sup> the Commission believes that it is appropriate to provide an exception from the trade acknowledgment and verification requirements in the circumstances where the execution facility on which the SBS transaction is executed is essentially already providing the same service for an SBS transaction executed on its platform. The Commission believes that providing an exception for SBS transactions executed on an SBSEF or national

<sup>168</sup> Clearing agencies' rules and/or procedures generally refer to "confirming" or "confirmation" of transactions rather than trade acknowledgment and verification, but as the Commission has noted, the process through which one counterparty acknowledges an SBS transaction and its counterparty verifies it, is the confirmation process. See Section I.A. above. Thus, clearing agency confirmation practices generally provide for the acknowledgment and verification of SBS transactions for purposes of this exception.

<sup>169</sup> See note 164, *supra*.

securities exchange, provided that the rules, procedures or processes of the SBSEF or exchange provide for the acknowledgment and verification of all terms of the SBS no later than the time required by paragraphs (b) and (d)(2) of Rule 15Fi-2, will serve the intended purpose of the rule in a more efficient manner than if the rule were applied without the exception because SBS Entities will not need processes or systems to provide trade acknowledgments for transactions when execution on the SBSEF or national securities exchange provides the same result. Such an exception is also generally consistent with the CFTC Rule, as two commenters urged.<sup>170</sup> This consistency will permit SBS Entities that are also registered as Swap Entities to rely on executing a transaction on an SBSEF or national securities exchange to comply with the requirements of Rule 15Fi-2 in the same manner they may rely on execution on a swap execution facility or designated contract market for compliance with the CFTC Rule.

The Commission further believes that it is appropriate to require, as part of the exception, that the rules, procedures or processes of the SBSEF or national securities exchange provide for the acknowledgment and verification of all terms of the SBS no later than the time required by paragraphs (b) and (d)(2) of the rule. Otherwise, the Commission is concerned that SBS transactions executed on SBSEFs or national securities exchanges could end up not being acknowledged and verified either pursuant to the rules, procedures or processes of the SBSEF or the exchange, or pursuant to the requirements of this rule, for an extended period of time, which would undermine the objective of the rule to provide legal certainty as to the terms of SBS transactions in a timely manner.

As adopted, the exception applies to transactions executed on either a security-based swap execution facility or a national securities exchange. Final Rule 15Fi-1(f) defines the term "security-based swap execution facility" to mean a security-based swap execution facility as defined in Section 3(a)(77) of the Exchange Act<sup>171</sup> that is registered pursuant to Section 3D of the Exchange Act,<sup>172</sup> and Final Rule 15Fi-1(g) defines the term "national securities exchange" to mean an exchange as defined in Section 3(a)(1) of the Exchange Act<sup>173</sup> that is registered pursuant to Section 6 of the Exchange

<sup>170</sup> MarkitSERV at 9; ISDA II at 3, 8.

<sup>171</sup> 15 U.S.C. 78c(a)(77).

<sup>172</sup> 15 U.S.C. 78c-4.

<sup>173</sup> 15 U.S.C. 78c(a)(1).



Act.<sup>174</sup> These definitions limit the exception in Final Rule 15Fi–2(f) to such organized platforms for the trading of SBSs that are registered with the Commission. The Commission believes that it is appropriate to impose this limitation, as those entities are subject to the Commission’s oversight, which will help to ensure that the exception supports the objectives of Final Rule 15Fi–2 to promote timely and accurate documentation of SBS transactions. The Commission will be able to review the operations of these entities, in particular how the rules, procedures, and processes for providing the trade acknowledgments and obtaining verification operate in practice.<sup>175</sup>

SBS Entities executing transactions on organized trading platforms that are not registered with the Commission, such as a foreign organized trading platform that is not registered with the Commission, are not within the scope of this exception, for the reasons discussed above. In such cases, an SBS Entity retains the obligation to comply with the trade acknowledgment and verification requirements of Final Rule 15Fi–2 when executing a transaction on one of these alternative platforms. The Commission notes, however, that an SBS Entity may allow such an alternative platform to provide a trade acknowledgment on its behalf, but the SBS Entity would retain ultimate responsibility for its own compliance with the rule.<sup>176</sup>

The exception in Rule 15Fi–2(f)(1) as adopted also addresses one commenter’s concern that SBSEFs may lack certain information necessary to confirm trades. Under the exception in Final Rule 15Fi–2(f)(1), an SBSEF or exchange’s rules, procedures or processes must provide for the acknowledgment and verification of all the terms of an SBS transaction—which is the same content as is required by Final Rule 15Fi–2(c) for a trade acknowledgment provided by an SBS Entity. Thus, if the rules, procedures or processes of the SBSEF or exchange do not provide for the acknowledgment and verification of all terms of an SBS transaction no later than the time required by paragraphs (b) and (d)(2) of Rule 15Fi–2, the exception would not be

available and an SBS Entity would itself be required to provide a trade acknowledgment for such transactions in compliance with Rule 15Fi–2.

## 2. Exception for Transactions Accepted for Clearing by a Clearing Agency

As noted above, the Commission is also adopting Final Rule 15Fi–2(f)(2), which provides an exception to the general requirements in Rule 15Fi–2 with respect to any SBS transaction that is submitted for clearing to a clearing agency, subject to certain conditions. In particular, the exception will apply only if: (A) The SBS transaction is submitted for clearing as soon as technologically practicable, but in any event no later than the time established for providing a trade acknowledgment under Final Rule 15Fi–2(b); and (B) the rules, procedures or processes of the clearing agency provide for or require the acknowledgement and verification of all terms of the security-based swap transaction prior to or at the same time that the security-based swap transaction is accepted for clearing.<sup>177</sup> For the agency model of clearing, the exception in paragraph (f)(2) of Rule 15Fi–2 will apply to the initial bilateral transaction between two counterparties that they submit to clearing—the alpha transaction—provided that the conditions are satisfied.<sup>178</sup> For the principal model of clearing, this exception will not apply to the original bilateral transaction between the two counterparties, as that transaction is not submitted for clearing.

The rules, procedures, and processes of registered clearing agencies that provide central counterparty services for SBSs are generally designed to ensure that the terms of SBS transactions submitted for clearing have been matched and confirmed prior to or at the same time the transaction is accepted by the registered clearing agency for clearing. In particular, the rules, procedures, and processes of registered clearing agencies that offer central counterparty services for SBS are designed to ensure that the clearing agency will accept an SBS transaction

for clearing only if it has been matched and confirmed prior to acceptance and processing by the registered clearing agency for clearing, either by an authorized execution or processing platform, through an inter-dealer broker, or through the clearing agency’s own communications with the parties to the transaction.<sup>179</sup> The Commission therefore believes that it is unnecessary to require an SBS Entity to comply with the trade acknowledgment and verification requirements of Rule 15Fi–2 for SBS transactions that are submitted to clearing, in circumstances where the clearing agency’s rules provide for the same result as those the rule is designed to achieve (subject to the conditions discussed).

The Commission also believes that it is appropriate to condition the exception on the requirement that the SBS transaction is submitted for clearing as soon as technologically practicable, but in any event no later than the time established for providing a trade acknowledgment under Final Rule 15Fi–2(b). The Commission is concerned that otherwise such SBS transactions could end up not being acknowledged and verified either pursuant to the rules of the clearing agency, or pursuant to the requirements of this rule, for an extended period of time, which would undermine the objective of the rule to provide legal certainty as to the terms of SBS transactions in a timely manner.

As adopted, the exception applies to transactions submitted to and accepted for clearing by a registered clearing agency that performs central counterparty services for SBS transactions, subject to certain conditions. Final Rule 15Fi–1(b) defines the term “clearing agency” to mean a clearing agency as defined in Section 3(a)(23) of the Exchange Act that is registered pursuant to Section 17A of the Exchange Act and that provides central counterparty services for SBS transactions. For the reasons discussed in Section F above, this definition limits the exception in Final Rule 15Fi–2(f) to clearing agencies that are registered with the Commission.

## 3. Trade Acknowledgment and Verification After Notice That an SBSEF or Exchange Has Not Acknowledged and Verified a Transaction or That a Transaction Has Not Been Accepted for Clearing by a Clearing Agency

As discussed above, the exception in Final Rule 15Fi–2(f)(1) applies only to SBS transactions executed on an SBSEF or a national securities exchange where

<sup>177</sup> Clearing agency rules, processes, and procedures generally refer to “confirming” transaction data as opposed to “acknowledgment” and “verification,” however, for purposes of Rule 15Fi–2(f)(2), the Commission is treating confirming transactions under these rules, processes, or procedures as equivalent to providing a trade acknowledgment and verifying it.

<sup>178</sup> In contrast, the exception in paragraph (e) of Rule 15Fi–2 as adopted will apply to the transactions that result once the clearing agency accepts the original bilateral transaction for clearing, namely the beta and gamma transactions to which the clearing agency is a counterparty. See *supra* Section II.F (discussing the exception for clearing transactions).

<sup>179</sup> See note 168 *supra*.

<sup>174</sup> 15 U.S.C. 78f.

<sup>175</sup> See Exchange Act Sec. 3D, 15 U.S.C. 78c–4 (statutory authority to oversee SBSEFs) and Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011) (proposing rules to register and regulate SBSEFs); see also Exchange Act Section 6, 15 U.S.C. 78f and Exchange Act Section 19, 15 U.S.C. 78s (statutory authority to oversee national securities exchanges).

<sup>176</sup> See discussion of an SBS Entity relying on a third party to provide a trade acknowledgment on its behalf in Section II.B.3, *supra*.

the rules, processes, or procedures of the execution facility provide for the acknowledgment and verification of all terms of the SBS no later than the time required by paragraphs (b) and (d)(2) of the rule. Likewise, the exception in Final Rule 15Fi-2(f)(2) applies only to SBS transactions that are timely submitted to clearing at a clearing agency where the rules of the clearing agency provide for or require the acknowledgment and verification of all terms of the security-based swap transaction prior to or at the same time that the security-based swap transaction is accepted for clearing. There might be instances even with respect to an SBSEF or national securities exchange that has such rules, procedures or processes, where an SBS Entity receives notice that an SBS transaction it executed on an SBSEF or a national securities exchange has not been acknowledged and verified. Similarly, there may be circumstances where an SBS submitted for clearing to a clearing agency is not accepted for clearing. In these circumstances, the Commission does not believe that the objectives of Rule 15Fi-2 would be satisfied unless the SBS Entity itself were to comply with the provisions of the rule, to help ensure that the SBS transaction is in fact acknowledged and verified. Thus, Rule 15Fi-2(f)(3) as adopted provides that, if an SBS Entity receives notice that an SBS transaction has not been acknowledged and verified pursuant to the rules, procedures or processes of an SBSEF or a national securities exchange, or accepted for clearing by a clearing agency, the SBS Entity shall comply with the requirements of Rule 15Fi-2 with respect to such SBS transaction as if such SBS transaction were executed at the time the SBS Entity receives such notice. This also makes clear how the timing requirements in paragraph (b) of Rule 15Fi-2 apply in these circumstances, where an SBS Entity would not know it has an obligation to provide a trade acknowledgment until it has received notice from the SBSEF or national securities exchange that the transaction has not been acknowledged and verified pursuant to its rules, procedures or processes, or notice from the clearing agency that the transaction has not been accepted for clearing.

The Commission notes that whether a contract that has not been acknowledged and verified by the SBSEF or national securities exchange, or that has not been accepted for clearing by a clearing agency, continues to exist may depend on the rules of the SBSEF, national securities exchange, or those of the clearing agency, or the

agreement of the counterparties. If the result is that the counterparties have executed an SBS transaction, then the SBS Entity would be required to comply with the requirements of Rule 15Fi-2 with respect to that transaction. To the extent that the result is that the parties have not executed an SBS transaction, or that the SBS transaction that was executed is now extinguished, then there is no SBS transaction for which it is necessary to comply with Rule 15Fi-2.

#### H. Exemption From Rule 10b-10

The Dodd-Frank Act amended the Exchange Act definition of “security” to include any “security-based swap.”<sup>180</sup> Consequently, security-based swaps, as securities, are fully subject to the federal securities laws and regulations, including Rule 10b-10 under the Exchange Act.<sup>181</sup> Rule 10b-10 generally requires that broker-dealers effecting securities transactions on behalf of or with customers, provide to their customers, at or before completion of the securities transaction, a written notification containing certain basic transaction terms.<sup>182</sup> The Commission anticipates that some SBS Entities may also be registered broker-dealers. Therefore, in the absence of an exemption, an SBS Entity that is also a broker or dealer could be required to comply with both Rule 10b-10 and Rule 15Fi-2 with respect to the same transaction. This could be duplicative and overly burdensome. The Commission thus proposed paragraph (f) of Rule 15Fi-1, which would provide that an SBS Entity that is also a broker or dealer and that complies with the requirement to provide a trade acknowledgment as required by proposed Rule 15Fi-1(b) with respect to an SBS transaction is exempt from the requirements of Exchange Act Rule 10b-10<sup>183</sup> with respect to the SBS transaction.

The proposed exemption in paragraph (f) would have applied solely to transactions in SBS in which an SBS Entity is also a broker or a dealer, and would not have applied to a transaction by a broker-dealer that is not also an SBS Entity. In other words, a broker-

dealer that is not an SBS Entity would continue to comply with Rule 10b-10 to the extent that it effects transactions in SBSs with customers.

The Commission did not receive any comments on the proposed exemption from Rule 10b-10 in proposed Rule 15Fi-1(f). In response to its July 2011 Exchange Act Exemptive Order<sup>184</sup> granting temporary exemptive relief from compliance with certain provisions of the Exchange Act that would have applied to SBS activities due to the expansion of the Exchange Act definition of “security” to include SBSs, the Commission received a comment letter that requested the Commission provide an exemption from Rule 10b-10 in connection with SBS transactions.<sup>185</sup> The commenter noted that we proposed to exempt registered broker-dealers from Rule 10b-10 if the broker complies with the confirmation requirements for SBSs that applies to SBS dealers. The commenter recommended that the Commission also exempt a broker from Rule 10b-10 with respect to its brokering activities, regardless of whether the broker is an SBS dealer.<sup>186</sup> The commenter suggested, when talking about certain categories of rules applicable to broker-dealers that include Rule 10b-10, that applying Rule 10b-10 would be unnecessary when applied to SBS dealing and brokering activities in light of the new SBS regulatory regime, and stated its view that broker-dealers that engage in SBS brokering activities should be exempt from pre-Dodd Frank provisions to the extent they comply with the corresponding SBS provisions that apply to SBS dealers.<sup>187</sup>

The Commission continues to believe that an exemption from Rule 10b-10 is appropriate to avoid potentially duplicative and overly burdensome documentation requirements on security-based swap transactions and thus it is adopting the exemption substantially as proposed but re-designated as Final Rule 15Fi-2(g) and with changes as noted below.<sup>188</sup>

As noted in Section B.1 above, because the rule applies solely to an SBS Entity that “purchases” or “sells” an SBS, it is effectively limited to principal transactions in which the SBS Entity is a counterparty to the transaction and is acting for its own account. Thus, the exemption from Rule

<sup>180</sup> Pub. L. 111-203, 124 Stat. 1376, 1755 Dodd-Frank Act Sec. 761(a)(2) (codified at Exchange Act Section 15 U.S.C. 78c 3(a)(10) (2010)).

<sup>181</sup> 17 CFR 240.10b-10.

<sup>182</sup> Examples of transaction terms included on a rule 10b-10 confirmation include: the date of the transaction; the identity, price, and number of shares bought or sold; the capacity of the broker-dealer; the dollar or yield at which a transaction in a debt security was effected, and under specified circumstances, the compensation paid to the broker-dealer by the customer or other parties. *Id.*

<sup>183</sup> 17 CFR 240.10b-10.

<sup>184</sup> See note 189, *infra*.

<sup>185</sup> Securities Industry and Financial Markets Association, dated Dec. 5, 2011 (“SIFMA”) at 5 (available at <http://www.sec.gov/comments/s7-27-11/s72711-10.pdf>).

<sup>186</sup> *Id.*

<sup>187</sup> *Id.* at 2-3.

<sup>188</sup> See Final Rule 15Fi-2(g).

10b–10 as proposed in Rule 15Fi–1(f) and as adopted in paragraph (g) of Rule 15Fi–2 applies solely to principal transactions. Final Rule 15Fi–2(g) has been modified from the proposal to make explicit that the exemption from Rule 10b–10 applies only when the SBS Entity is purchasing from or selling to a counterparty (*i.e.*, an SBS Entity is acting as principal for its own account in a security-based swap transaction). The Commission recognizes that some SBS Entities may also engage in SBS brokerage or agency transactions. Any broker acting as an agent in an SBS transaction, regardless of whether it is also registered as an SBS Entity, would continue to be required to comply with Rule 10b–10.<sup>189</sup> Regarding the comment recommending that a broker that complies with the SBS confirmation rule with respect to its brokering activity in SBSs be exempt from Rule 10b–10, the Commission believes such an exemption is unnecessary because the trade acknowledgment and verification requirements adopted today in Rule 15Fi–2 are designed for, and only apply to, principal transactions by an SBS dealer. The rule as adopted

<sup>189</sup> On July 1, 2011, the Commission issued an order granting temporary exemptive relief from compliance with certain provisions of the Exchange Act that would have applied to SBS activities due to the expansion of the Exchange Act definition of “security” to include SBSs. Subject to certain conditions, the order provided temporary exemptions (including from Exchange Act Rule 10b–10 relating to the confirmation of securities transactions) in connection with SBS activity by certain eligible contract participants (as defined in section 1a of the Commodity Exchange Act) and registered broker-dealers. See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revisions of the Definition of “Security” to Encompass Security-Based Swaps, Exchange Act Release No. 64795 (Jul. 1, 2011), 76 FR 39927 (Jul. 7, 2011) (“Exchange Act Exemptive Order”). The Exchange Act Exemptive Order also provided that pursuant to section 36 of the Exchange Act, until such time as the underlying exemptive relief expires, no contract entered into on or after July 16, 2011 shall be void or considered voidable by reason of section 29(b) of the Exchange Act because any person that is a party to the contract violated a provision of the Exchange Act for which the Commission provided exemptive relief in the Exchange Act Exemptive Order. On February 5, 2014, the Commission extended the expiration date for the temporary exemption relating to Exchange Act Rule 10b–10 until the earliest compliance date set forth in any final rules regarding trade acknowledgment and verification of SBS transactions. See Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of “Security” to Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 71485 (Feb. 5, 2014), 79 FR at 7734 (Feb. 10, 2014). With the adoption of this Final Rule, the exemption from Exchange Act Rule 10b–10 provided for in the Exchange Act Exemptive Order, as well as the related exemption from Section 29(b) with respect to Rule 10b–10, will expire upon the compliance date of Rule 15Fi–2, which is discussed further in Section V.A. below.

today thus does not apply to brokerage or agency transactions, which are different in structure and involve different activity by a broker than principal transactions by an SBS dealer. In contrast, Rule 10b–10 applies to both principal and agency transactions, and contains required disclosures specifically for when a broker-dealer is acting as agent.<sup>190</sup> Since Rule 15Fi–2 does not require a trade acknowledgment for an SBS Entity’s brokerage or agency transactions, and therefore compliance with Rule 15Fi–2 would not result in any duplication of efforts by the SBS Entity effecting the brokerage or agency transaction, the Commission does not believe that there is a need to provide an exemption from providing a confirmation under Rule 10b–10 for an SBS Entity’s brokerage or agency transactions.

The Commission also is changing the exemption in Final Rule 15Fi–2(g) to clarify that an SBS Entity that is also a broker or dealer may rely on the exemption from Rule 10b–10 if it complies with either paragraph (a) or (d)(2) of Final Rule 15Fi–2. This change makes it clear that the exemption is also available to an SBS Entity that receives a trade acknowledgment from its counterparty to an SBS and timely verifies or disputes the terms of the trade acknowledgment in compliance with the rule. The proposed exemption in Rule 15Fi–1(f) from Rule 10b–10 would have applied only to an SBS Entity that sent a trade acknowledgment. The Commission recognizes, however, that an SBS Entity that is also a broker-dealer and that receives a trade acknowledgment pursuant to Rule 15Fi–2 from its counterparty to the SBS may nevertheless have an independent obligation under Rule 10b–10 to send that counterparty a confirmation. The Commission believes that not exempting the SBS Entity that receives and responds to the trade acknowledgment from the requirement to send its counterparty a confirmation for the same transaction raises the same potentially duplicative and overly burdensome documentation requirements on security-based swap transactions if both Rules 10b–10 and 15Fi–2 were to apply to the same transactions. Thus, the Commission believes that it is appropriate to provide an exemption from Rule 10b–10 in this situation to avoid duplicative and overly burdensome documentation requirements on security-based swap transactions.

<sup>190</sup> See Rule 10b–10(a)(2)(i).

### III. Cross-Border Application of Trade Acknowledgment and Verification Requirements

#### A. Proposed Application

In the Cross-Border Proposing Release, the Commission preliminarily interpreted the Title VII requirements associated with registration to apply generally to the activities of registered entities.<sup>191</sup> In reaching that preliminary conclusion, the Commission did not concur with the views of certain commenters that the Title VII requirements should not apply to the foreign security-based swap activities of registered entities, stating that such a view could be difficult to reconcile with, among other things, the statutory language describing the requirements applicable to security-based swap dealers.<sup>192</sup>

Implementing those principles, the Commission preliminarily identified the statutory provision related to documentation standards—which in part requires the Commission to adopt rules governing documentation standards for SBS Entities—as addressing entity-level requirements relating to the security-based swap dealer as a whole, rather than requirements specifically applicable to particular transactions,<sup>193</sup> and the Commission accordingly proposed to apply the entity-level requirements on a firm-wide basis to address risks to the security-based swap dealer as a whole.<sup>194</sup> The Commission similarly expressed the preliminary view that major security-based swap participants

<sup>191</sup> See Cross-Border Proposing Release, 78 FR at 30986 (“We are proposing to apply the Title VII requirements associated with registration (including, among others, capital and margin requirements and external business conduct requirements) to the activities of registered entities to the extent we have determined that doing so advances the purposes of Title VII.” (footnotes omitted)).

<sup>192</sup> See *id.* at 30986 (“Although some commenters suggested that a territorial approach would prohibit the Commission from applying Title VII to the foreign security-based swap activities of even registered entities, such an interpretation of the application of Title VII to registered entities is difficult to reconcile with the statutory language describing the requirements applicable to registered security-based swap dealers, with the text of Section 30(c), or with the purposes of Title VII and the nature of risks in the security-based swap market as described above. We have long taken the view that an entity that has registered with the Commission subjects itself to the entire regulatory system governing such registered entities.”).

<sup>193</sup> See *id.* at 31013 (addressing the documentation standard requirements of Exchange Act Section 15F(i) in conjunction with other risk management requirements applicable to registered security-based swap dealers); see generally *id.* at 31009–16 (comparing entity-level and transaction-level requirements generally).

<sup>194</sup> See *id.* at 31011.

should be required to adhere to the entity-level requirements.<sup>195</sup>

The Commission did not propose any exception from the application of the entity-level requirements to security-based swap dealers.<sup>196</sup> The Commission, however, has adopted rule amendments to provide exceptions from the business conduct requirements under Exchange Act Section 15F(h)—other than supervision requirements pursuant to Exchange Act Section 15F(h)(1)(B)—for security-based swap dealers and major security-based swap participants in connection with certain foreign security-based swap activity.<sup>197</sup>

#### B. Commenter Views

Certain commenters expressed views challenging the proposed cross-border scope of the trade acknowledgment and verification requirements. In particular, one commenter expressed the view that these requirements (as well as certain other Title VII requirements) should be deemed to be transaction-level requirements, and that their cross-border application should differ depending on the type of counterparty

in question.<sup>198</sup> A commenter to the Proposing Release stated the view that when practices imposed on U.S. entities are more burdensome than corresponding practices in other jurisdictions, those practices should apply only to U.S. customer business.<sup>199</sup>

One commenter generally urged us to follow cross-border approaches that are similar to those taken by the CFTC.<sup>200</sup> The CFTC has taken a different position with regard to corresponding requirements pursuant to the CEA.<sup>201</sup>

<sup>198</sup> See SIFMA/FSR/FIA Letter at A22–23 (stating in relevant part that confirmation requirements should be considered to be transaction-level requirements, and that the application of such requirements should depend on the circumstances of a particular security-based swap including the status of the counterparty; also citing CFTC cross-border guidance which identifies those requirements as being transaction-level).

<sup>199</sup> See ISDA Letter (Feb. 22, 2011) at 8 (“In the interests of maintaining the competitiveness of U.S. markets and U.S. SBS Entities, we believe that to the extent practices imposed on U.S. SBS Entities are different from and more burdensome than those imposed on equivalent entities in other jurisdictions, those practices should apply to U.S. customer business only. As we have stated previously, it is essential that U.S. regulations not hamper the overseas activities of U.S. SBS Entities. Nor should non-U.S. entities find access to the U.S. markets impaired.”).

<sup>200</sup> See, e.g., CDEU Letter at 2 (“Conflicting regulatory regimes will lead to an inefficient financial system, increasing compliance costs without securing any further reductions in systemic risks. Accordingly, the SEC’s proposed application and rules relating to the cross-border application of Title VII should ensure that such rules will not conflict with the guidance adopted by the CFTC. The SEC should also work closely with the CFTC when determining whether substituted compliance is applicable with respect to a particular jurisdiction.”).

<sup>201</sup> Under the CFTC’s cross-border guidance, trade confirmation requirements pursuant to CEA section 4s(i) are considered to be “Category A” transaction-level requirements. See CFTC, “*Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations*,” 78 FR 45292, 45335 (July 26, 2013). In contrast to the Commission’s approach with regard to security-based swaps (which would apply those requirements to the entirety of registered security-based swap dealers’ security-based swap businesses, with the availability of substituted compliance for non-U.S. dealers), under the CFTC’s guidance such Category A transaction-level swap requirements:

(a) Generally appear not to apply to a non-U.S. swap dealer’s transaction with a non-U.S. counterparty (other than a guaranteed or conduit affiliate). See *id.* at 45352–53 (stating that “generally there may be a relatively greater supervisory interest on the part of foreign regulators with respect to transactions between two counterparties that are non-U.S. persons so that application of the Category A Transaction-Level Requirements may not be warranted.”).

(b) Generally appear to apply to a non-U.S. swap dealer’s transactions with U.S. counterparties (other than foreign branches of U.S. banks) without the availability of substituted compliance, with the proviso that such a non-U.S. dealer would be deemed in compliance with the relevant Dodd-Frank requirements “where it complies with requirements in its home jurisdiction that are essentially identical to the Dodd-Frank requirements.” See *id.* at 45353.

#### C. Response to Comments and Final Interpretation

The Commission continues to believe that the trade acknowledgment and verification requirements are entity-level requirements that apply to a security-based swap dealer’s or a major security-based swap participant’s business with foreign counterparties to the same extent that they apply to the dealer’s or major participant’s U.S. business.<sup>202</sup> This scope is consistent with Exchange Act Section 15F(i), which provides that each registered security-based swap dealer and major security-based swap participant “shall conform with such standards as may be prescribed by the Commission, by rule or regulation, that relate to timely and accurate confirmation, processing, netting, documentation, and valuation of all security-based swaps.”<sup>203</sup>

In reaching this conclusion, the Commission is persuaded that the trade acknowledgment and verification requirements play an important role in addressing risks to the security-based swap dealer and the major security-based swap participant as a whole, including risks related to the entity’s financial stability. In this regard, we have taken into account commenter views that these requirements should be deemed to be transaction-level requirements, and that their cross-border application should differ depending on the type of counterparty in question,<sup>204</sup> and that when practices imposed on U.S. entities are more burdensome than corresponding practices in other jurisdictions, those practices should apply only to U.S. customer business.<sup>205</sup> We further recognize that the CFTC has taken a different position with regard to corresponding requirements pursuant to the CEA, and have considered

(c) Generally appear to apply to the transactions of a swap dealer that is a foreign branch of a U.S. bank, but with substituted compliance available for the foreign branch’s transactions with non-U.S. counterparties. See *id.* at 45350–51 (noting “the interests of foreign regulators in applying their transaction-level requirements to a swap taking place in their jurisdiction” along with the fact that foreign branches “are subject generally to direct or indirect oversight by U.S. regulators because they are part of a U.S. person”). Substituted compliance generally would not be available for that foreign branch’s transactions with U.S. counterparties, unless the counterparty also is a foreign branch. See *id.* at 45350 (noting the CFTC’s “strong supervisory interests in entities that are part of or extensions of” U.S. swap dealers).

<sup>202</sup> See note 192, *supra* (Cross-Border Proposing Release noted our longstanding view that “an entity that has registered with the Commission subjects itself to the entire regulatory system governing such registered entities”).

<sup>203</sup> 15 U.S.C. 78o–10(i).

<sup>204</sup> See note 198, *supra*.

<sup>205</sup> See note 199, *supra*.

<sup>195</sup> See *id.* at 31035.

<sup>196</sup> “The Commission preliminarily believes that entity-level requirements are core requirements of the Commission’s responsibility to ensure the safety and soundness of registered security-based swap dealers. The Commission preliminarily believes that it would not be consistent with this mandate to provide a blanket exclusion to foreign security-based swap dealers from entity-level requirements applicable to such entities.” *Id.* at 31024 (footnotes omitted). The Commission further expressed the preliminary view that concerns regarding the application of entity-level requirements to foreign security-based swap dealers would largely be addressed through the proposed approach to substituted compliance. See *id.*

<sup>197</sup> In part, U.S. and non-U.S. security-based swap dealers have been exempted from application of those business conduct standards to their “foreign business.” See Exchange Act Rule 3a71–3(a)(8), (a)(9), (c) (excepting foreign dealers in connection with any transaction with a non-U.S. counterparty that does not involve certain activities in the U.S., or any transaction with a U.S. counterparty that is a transaction through that counterparty’s foreign branch; also excepting U.S. dealers in connection with any transaction through the dealer’s foreign branch with a non-U.S. counterparty or with a U.S. counterparty that is conducted through that counterparty’s foreign branch); see also Business Conduct Adopting Release, 81 FR at 30065–69.

U.S. and non-U.S. major security-based swap participants also have been exempted from those business conduct standards with respect to certain foreign activities. See Exchange Act Rule 3a67–10(d) (excepting foreign major participants in connection with any transaction with a non-U.S. counterparty and any transaction with a U.S. counterparty that is a transaction through that counterparty’s foreign branch; also excepting U.S. major participants in connection with any transactions conducted through a foreign branch with a non-U.S. counterparty or with a U.S.-person counterparty that constitutes a transaction through the counterparty’s foreign branch); see also Business Conduct Adopting Release, 81 FR at 30069.

commenter views urging us to follow cross-border approaches similar to those taken by the CFTC.<sup>206</sup>

We believe it is especially significant that, as we previously recognized, if an SBS transaction “is not reduced to writing, a court may have to supply contract terms upon which there was no previous agreement,” and prudent practice requires that “the parties document the transaction in a complete and definitive written record so there is legal certainty about the terms of the agreement in case those terms are later disputed.”<sup>207</sup> The GAO further has recognized that “[h]aving unconfirmed trades could allow errors to go undetected that might subsequently lead to losses and other problems,” and that the associated operational risks “have the potential to contribute to broader market problems.”<sup>208</sup> As a result, an alternative approach that does not require a registered entity to take steps to reduce the terms of a transaction to writing and take steps to help detect any errors could be expected to contribute to operational risk and legal uncertainty. Those risks would impact the entity’s business as a whole, and not merely specific security-based swap transactions. Because those risks may raise questions regarding the validity—and even the existence—of outstanding security-based swaps, those risks may also hinder the settlement process and lead to instability within the broader security-based swap market. Accordingly, the Commission believes that it is appropriate to apply these trade acknowledgment and verification requirements to the entirety of a security-based swap dealer’s and major security-based swap participant’s security-based swap business.<sup>209</sup>

<sup>206</sup> See notes 200 and 201, *supra*.

<sup>207</sup> See Proposing Release, 76 FR at 3860.

<sup>208</sup> See GAO Confirmation Report, *supra* note 9, at 15. The GAO further noted: “Errors could be made at any time—for example, counterparties could miscommunicate when making a trade or dealers could enter the wrong trade data into their systems. If such errors go undetected, a dealer could make an incorrect premium payment to a counterparty or inaccurately measure and manage risk exposures, notably market and counterparty credit risks. Similarly, errors could lead to legal disputes between a dealer and a counterparty if a credit event triggered a contract settlement.” *Id.*

<sup>209</sup> Given the role of trade acknowledgment and verification practices in helping avoid disputes regarding the existence and terms of security-based swaps, and so in helping to avoid risks to market participants, the entity-level nature of the associated requirements may be distinguished from certain transaction-level business conduct rules that the Commission previously adopted related to recommendations, communications and disclosures. See Business Conduct Adopting Release, 81 FR at 30065–69 (addressing business conduct standards described in Exchange Act Section 15F(h) and underlying rules and regulations).

In sum, we believe that the considerations discussed above support the conclusion that an alternative approach—whereby the trade acknowledgment and verification requirements are applied only to transactions involving U.S. counterparties (and/or transactions connected with dealing activity in the U.S.)—could lead to operational risk and legal uncertainty, which would impact the registered entity as well as its counterparties. For those reasons, we conclude that for purposes of the Exchange Act, the trade acknowledgment and verification requirements are entity-level requirements that are applicable to the entirety of a registered dealer’s and major participant’s security-based swap business.<sup>210</sup>

#### IV. Availability of Substituted Compliance for Trade Acknowledgment and Verification Requirements

##### A. Existing Substituted Compliance Rule

Earlier this year, the Commission adopted Exchange Act Rule 3a71–6 to provide that non-U.S. SBS Entities could satisfy applicable business conduct requirements under Section 15F by complying with comparable regulatory requirements of a foreign jurisdiction, subject to certain conditions. The rule in part provides that the Commission shall not make a determination providing for substituted compliance unless the Commission determines, among other things, that the foreign regulatory requirements are comparable to otherwise applicable requirements.<sup>211</sup> In adopting that substituted compliance rule, the Commission addressed a range of issues and concerns that commenters had raised in response to the substituted compliance proposal that was set forth in the Cross-Border Proposing Release.

When the Commission adopted a substituted compliance rule that solely addressed the business conduct requirements, it stated that it expected to assess the potential availability of substituted compliance in connection with other requirements when the Commission considers final rules to implement those requirements.<sup>212</sup>

<sup>210</sup> Concerns regarding the application of such entity-level requirements in connection with foreign activities further may be addressed through the potential availability of substituted compliance. See note 196, *supra*.

<sup>211</sup> See Business Conduct Adopting Release, 81 FR at 30074.

<sup>212</sup> As proposed, substituted compliance potentially would have been available in connection with the requirements applicable to security-based swap dealers pursuant to Exchange

##### B. Response to Comments and Final Rule

The Commission is amending Exchange Act rule 3a71–6 to provide SBS Entities that are not U.S. persons with the potential to avail themselves of substituted compliance to satisfy the Title VII trade acknowledgment and verification requirements. In amending the rule, the Commission concludes that the principles associated with substituted compliance for the business conduct requirements in large part should similarly apply to the trade acknowledgment and verification requirements. Accordingly, except as discussed below, the revised substituted compliance rule applies to the trade acknowledgment requirements in the same manner as it applies to the business conduct requirements.<sup>213</sup>

##### 1. Basis for Substituted Compliance in Connection With the Trade Acknowledgment and Verification Requirements

In light of the global nature of the security-based swap market and the prevalence of cross-border transactions within that market, there is the potential that the application of the Title VII trade acknowledgment and verification requirements may lead to requirements that are duplicative of or in conflict with applicable foreign requirements, even when the two sets of requirements implement similar goals and lead to similar results. Those results have the potential to disrupt existing business relationships, and, more generally, to reduce competition and market efficiency.<sup>214</sup>

To address those effects, the Commission concludes that under certain circumstances it may be appropriate to allow for the possibility of substituted compliance whereby market participants may satisfy the trade acknowledgment and verification requirements by complying with comparable foreign requirements. Allowing for the possibility of

Act Section 15F, other than the registration requirements applicable to dealers. Because the trade acknowledgment and verification requirements being adopted today are grounded in Section 15F, substituted compliance generally would have been available for those requirements under the proposal.

<sup>213</sup> The discussions in the Business Conduct Adopting Release, including those regarding consideration of supervisory and enforcement practices (*see id.* at 30079), regarding certain multi-jurisdictional issues (*see id.* at 30079–80), and regarding application procedures (*see id.* at 30080–81) are applicable to the trade acknowledgment and verification requirements.

<sup>214</sup> See generally Business Conduct Adopting Release, 81 FR at 30073–74 (addressing basis for making substituted compliance available in the context of the business conduct requirements).

substituted compliance in this manner may be expected to help achieve the benefits of the trade acknowledgment and verification requirements—helping to curb legal uncertainty and operational risk to participants in security-based swap transactions and in the broader market—in a way that helps avoid regulatory duplication or conflict and hence promotes market efficiency, enhances competition and facilitates a well-functioning global security-based swap market. Accordingly, paragraph (d) of the rule has been revised to identify the trade acknowledgment and verification requirements of Title VII as being potentially eligible for substituted compliance.<sup>215</sup>

## 2. Comparability Criteria, and Consideration of Related Requirements

As discussed when we adopted Exchange Act rule 3a71-6, the Commission will endeavor to take a holistic approach in determining the comparability of foreign requirements for substituted compliance purposes, focusing on regulatory outcomes as a whole rather than on requirement-by-requirement similarity.<sup>216</sup> The Commission's comparability assessments associated with the trade acknowledgment and verification rules accordingly will consider whether, in the Commission's view, the foreign regulatory system achieves regulatory outcomes that are comparable to the regulatory outcomes associated with those Exchange Act requirements.

In response to commenter requests for guidance regarding criteria that the Commission will consider as it assesses comparability,<sup>217</sup> the final rule provides that prior to making a substituted compliance determination in connection with the trade acknowledgment and verification requirements, the Commission intends to consider whether the information that is required to be provided pursuant to the requirements of the foreign financial regulatory system, and the manner and timeframe by which that information must be provided, are comparable to those required pursuant to the applicable Exchange Act provisions.<sup>218</sup>

<sup>215</sup> Paragraph (a)(1) of the rule provides that the Commission may, conditionally or unconditionally, by order, make a determination with respect to a foreign financial regulatory system that compliance with specified requirements under the that foreign financial system by a security-based swap dealer and/or by a registered major security-based swap participant, or class thereof, may satisfy the corresponding requirements identified in paragraph (d) of the rule that would otherwise apply.

<sup>216</sup> See Business Conduct Adopting Release, 81 FR at 30078-79.

<sup>217</sup> See *id.*

<sup>218</sup> See Exchange Act Rule 3a71-6(d)(2)(i).

In application, the Commission may determine to conduct its comparability analyses regarding the trade acknowledgment and verification requirements in conjunction with comparability analyses regarding other Exchange Act requirements that, like the trade acknowledgment and verification requirements, promote risk management in connection with security-based swap dealers and major security-based swap participants. Accordingly, depending on the applicable facts and circumstances, the comparability assessment associated with the trade acknowledgment and verification requirements may constitute part of a broader assessment of the foreign regulatory system's risk mitigation requirements, and the applicable comparability assessments may be conducted at the level of those risk mitigation requirements as a whole.

## V. Effective and Compliance Dates

As addressed below, Rules 15Fi-1 and 15Fi-2 being adopted today will be effective 60 days following publication in the **Federal Register** and will have a compliance date that is the same as the compliance date of the SBS Entity registration rules. If any provision of Rules 15Fi-1 and 15Fi-2, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

### A. Trade Acknowledgment and Verification Rule

Final Rules 15Fi-1 and 15Fi-2 will be effective 60 days from the date of the publication of those rules in the **Federal Register**.

However, the Commission notes that only registered SBS Entities must conform to the standards of Final Rules 15Fi-1 and 15Fi-2. Thus, SBS Entities will not be required to comply with Final Rules 15Fi-1 and 15Fi-2 until they are registered. Therefore, the Commission is adopting a compliance date for Final Rules 15Fi-1 and 15Fi-2 that is the same as the compliance date of the SBS Entity registration rules, which is the later of: Six months after the date of publication in the **Federal Register** of a final rule release adopting rules establishing capital, margin and segregation requirements for SBS Entities; the compliance date of final rules establishing recordkeeping and reporting requirements for SBS Entities; the compliance date of final rules establishing business conduct requirements under Exchange Act

Sections 15F(h) and 15F(k); or the compliance date for final rules establishing a process for a registered SBS Entity to make an application to the Commission to allow an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on the SBS Entity's behalf.<sup>219</sup> This timing should provide SBS Entities ample time to review the final trade acknowledgment and verification rules and determine how they will comply.

Two commenters suggested that we should implement the trade acknowledgment rule in phases.<sup>220</sup> One suggested that the trade acknowledgment requirements should be "both phased and aspirational" because it may only become "workable in the years to come."<sup>221</sup> This commenter suggested that the Commission engage in an ongoing dialogue with the leaders of the SBS industry to tighten the trade acknowledgment timeframe over an extended period.<sup>222</sup> The other commenter suggested that the suggested phases could be based, for example, upon the complexity of products or the average time to confirm similar transactions.<sup>223</sup> Otherwise, the commenter speculated that "premature implementation" could cause unspecified "adverse market consequences."<sup>224</sup>

At this time, the Commission is not adopting a phased-in compliance schedule or adopting timing requirements that tighten over time. The Commission believes the compliance date of Final Rules 15Fi-1 and 15Fi-2 is sufficient for SBS Entities to come into full compliance because: (1) The subset of SBS Entities that are also swap dealers or major swap participants have been required to comply with the CFTC Rule since 2014,<sup>225</sup> which suggests that compliance with the Commission's substantially similar Final Rules should not pose novel compliance challenges

<sup>219</sup> See Registration Process for Securities-Based Swap Dealers and Security-Based Swap Participants, Exchange Act Release No. 75611 (Aug. 5, 2015), 80 FR 48964 (Aug. 14, 2015).

<sup>220</sup> ISDA I at 5; MarkitSERV at 2, 11.

<sup>221</sup> ISDA I at 5.

<sup>222</sup> *Id.* at 6.

<sup>223</sup> MarkitSERV at 11.

<sup>224</sup> *Id.*

<sup>225</sup> The CFTC Rule contained a phased implementation schedule, which provided that Swap Entities would have additional time to provide a trade acknowledgment or confirm a transaction, as applicable, depending on the asset class of the swap. The implementation schedule required full compliance with the rule's timing requirements for all transactions in all asset classes executed after August 31, 2014. For a full discussion of the phased compliance schedule, see 77 FR at 55941.

for SBS Entities that are also swap dealers or major swap participants; (2) as discussed in the prior paragraph, no SBS Entity will be required to comply with the Final Rules until they are registered, and the requirement to register will not arise until the future point when the Commission has adopted certain other enumerated SBS rules; and (3) the timing requirement adopted in paragraph (b) of the Rule 15Fi-2 as compared to the proposed rule should ease SBS Entities' challenges meeting their compliance obligations when the rule does come into force. Thus, the Commission believes that the rule as adopted effectively addresses the concerns underlying the suggestion for a phased-in approach.

#### B. Substituted Compliance Rule

The effective date of these amendments to Exchange Act Rule 3a71-6 will be 60 days following publication in the **Federal Register**.

Earlier this year, when the Commission adopted Rule 3a71-6 to provide for substituted compliance in conjunction with the final rules associated with the business conduct requirements, the Commission stated that the effective date of the substituted compliance rule would be 60 days following publication in the **Federal Register**. The Commission further stated that there would be no separate compliance date in connection with the substituted compliance rule because the rule did not impose obligations upon entities separate and apart from the underlying business conduct requirements. The Commission added that security-based swap dealers and major security-based swap participants would not be required to comply with those requirements until they are registered.<sup>226</sup>

The same principles apply to this amendment to the substituted compliance rule, as security-based swap dealers and major security-based swap participants will not be required to comply with the underlying trade acknowledgment and verification requirements until they are registered. Accordingly, there will be no separate compliance date for the substituted compliance rule. As we noted in connection with the business conduct requirements, the Commission would consider substituted compliance requests that are submitted prior to the compliance date for the entity registration requirements.<sup>227</sup>

<sup>226</sup> See Business Conduct Adopting Release, 81 FR at 30082.

<sup>227</sup> See *id.*

## VI. Paperwork Reduction Act

### A. Introduction

The Paperwork Reduction Act of 1995 (“PRA”)<sup>228</sup> imposes certain requirements on Federal agencies in connection with their conducting or sponsoring any “collection of information.”<sup>229</sup> An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. In addition, 44 U.S.C. 3507(a)(1)(D) provides that before adopting (or revising) a collection of information requirement, an agency must, among other things, publish a notice in the **Federal Register** stating that the agency has submitted the proposed collection of information to the Office of Management and Budget (“OMB”) and setting forth certain required information, including (1) a title for the collection of information; (2) a summary of the collection of information; (3) a brief description of the need for the information and the proposed use of the information; (4) a description of the likely respondents and proposed frequency of response to the collection of information; (5) an estimate of the paperwork burden that shall result from the collection of information; and (6) notice that comments may be submitted to the agency and director of OMB.<sup>230</sup>

Final Rule 15Fi-2 and Rule 3a71-6 contain “collection of information requirements” within the meaning of the PRA. Final Rule 15Fi-1 defines relevant terms and is not a “collection of information.”

### B. Rule 15Fi-2

In accordance with 44 U.S.C. 3507 and 5 CFR 1320.11, the Commission submitted proposed Rule 15Fi-1 to OMB for review. The title of the new information collection will be “Rule 15Fi-2—Trade Acknowledgment and Verification of Security-Based Swap Transactions.” Compliance with the collection of information requirements is mandatory. The OMB has assigned control number 3235-0713 to the new collection of information.

In the proposing release, the Commission solicited comment on the collection of information requirements and the accuracy of the Commission's statements. As discussed more fully above in Section I.A., the Commission received seven comments in total on the proposed rule. One commenter raised

<sup>228</sup> 44 U.S.C. 3501 *et seq.*

<sup>229</sup> 44 U.S.C. 3502(3).

<sup>230</sup> 44 U.S.C. 3507(a)(1)(D) (internal formatting omitted); see also 5 CFR 1320.5(a)(1)(iv).

an issue with the Commission's estimate of the cost for each SBS Entity to develop an internal order and trade management systems (“OMS”), and is addressed below.

### 1. Summary of Collection of Information

As discussed above, Exchange Act Section 15F(i)(1) provides that SBS Entities “shall conform with such standards as may be prescribed by the Commission, by rule or regulation, that relate to timely and accurate confirmation, processing, netting, documentation, and valuation of all security-based swaps.”<sup>231</sup> Section 15F(i)(2) of the Exchange Act further provides that the Commission must adopt rules governing documentation standards for SBS Entities. Accordingly, the Final Rules provide documentation standards for the timely and accurate acknowledgment and verification of SBS transactions by SBS Entities. Rule 15Fi-1 contains definitions of the relevant terms. Rule 15Fi-2 contains seven paragraphs: (a) The trade acknowledgment obligations of specific SBS Entities; (b) the prescribed time frames under which a trade acknowledgment must be sent; (c) the form and content requirements of the trade acknowledgment; (d) SBS Entities' verification obligations; (e) a limited exception from the requirement to provide a clearing agency a trade acknowledgment in a clearing transaction, (f) a limited exception from the requirement to provide a trade acknowledgment for certain transactions executed on a security-based swap execution facility or a national securities exchange or accepted for clearing by a clearing agency; and (g) a limited exemption from the requirements of Exchange Act Rule 10b-10<sup>232</sup> for a broker-dealer acting as principal for its own account in a security-based swap transaction.

Under paragraph (a) of Rule 15Fi-2, sending an SBS trade acknowledgment is the obligation of a particular SBS Entity (*i.e.*, an SBS dealer or major-SBS participant) depending on whether the SBS Entity and its counterparty are SBS dealers or major SBS participants and/or in accordance with any agreements between the counterparties that delineate the trade acknowledgment responsibility.

Paragraph (b) of Rule 15Fi-2 requires trade acknowledgments to be provided promptly, but in no event later than the end of the first business day following

<sup>231</sup> 15 U.S.C. 78o-8.

<sup>232</sup> 17 CFR 240.10b-10.

the day of execution.<sup>233</sup> Paragraph (c) of Rule 15Fi-2 requires trade acknowledgments to be provided through electronic means that provide reasonable assurance of delivery and must disclose all the terms of the security-based swap transaction.<sup>234</sup> Paragraph (d)(1) of Rule 15Fi-2 requires SBS Entities to establish, maintain, and enforce policies and procedures reasonably designed to obtain prompt verification of SBS trade acknowledgments. Regardless of the method of transmittal, when an SBS Entity receives a trade acknowledgment, pursuant to paragraph (d)(2) of the rule, it must promptly verify the accuracy of the trade acknowledgment or dispute the terms with its counterparty.

Paragraphs (e), (f), and (g) of Final Rule 15Fi-2 are exemptive provisions and are not a collection of information.

## 2. Proposed Use of Information

The trade acknowledgment and verification requirements of Rule 15Fi-2 apply to both types of SBS Entities depending on whether the entity and its counterparty are SBS dealers or major SBS participants and on any agreements between the counterparties addressing the obligation to send a trade acknowledgment. Generally, the transaction details that must be provided in a trade acknowledgment serve as a written record by which the counterparties to a transaction memorialize the terms of a transaction. In effect, the trade acknowledgment reflects the contract entered into between the counterparties. In addition, the rule's verification requirements are intended to ensure that the written record of the transaction (*i.e.*, the trade acknowledgment) accurately reflects the terms of the transaction as understood by the respective counterparties. In situations in which an SBS Entity is provided a trade acknowledgment that is not an accurate reflection of the agreement, Rule 15Fi-2 requires the SBS Entity to dispute the terms of the transaction.

## 3. Respondents

Rule 15Fi-2 applies only to SBS Entities, that is, to SBS dealers and major SBS participants, both of which will be registered with the Commission. In the Proposing Release the Commission stated its belief that approximately 50 entities may meet the definition of SBS dealer, and up to five entities may meet the definition of major SBS participant. We received no

comments on these estimates and continue to believe they are appropriate. Thus, approximately 55 entities may be required to register with the Commission as SBS Entities and thus, would be subject to the trade acknowledgment and verification requirements of Rule 15Fi-2.

## 4. Total Initial and Annual Reporting and Recordkeeping Burdens

Pursuant to Rule 15Fi-2, all SBS transactions must be acknowledged and verified through the methods and by the timeframes prescribed in the rule. Collectively, paragraphs (a), (b), (c), and (d) of Rule 15Fi-2 identify the information to be included in a trade acknowledgment; the party responsible for sending the trade acknowledgment; the permissible methods for sending the trade acknowledgment; and criteria for verifying the terms of a trade acknowledgment. In 2015, there were 2,436,531 single-name credit default swap ("CDS") transactions reported to the DTCC Derivatives Repository Limited Trade Information Warehouse ("TIW").<sup>235</sup> For purposes of this analysis, we assume there were approximately 2.44 million single-name CDS transactions in 2015. In addition, although we lack comprehensive data on equity swaps and other security-based swaps, we have estimated in prior rulemakings that single-name CDS represent approximately 82% of the total SBS market. This implies that there are an additional 540,000 transactions, or approximately 2.98 million total SBS transactions. Assuming that at least one SBS Entity is a party to every SBS transaction, the Commission estimates that the number of SBS transactions subject to Rule 15Fi-2 would be approximately 54,182 transactions per SBS Entity per year.<sup>236</sup>

The Commission believes that most transactions will be electronically executed and cleared through the facilities of a clearing agency. The Commission understands that the clearing of SBS transactions through the facilities of a clearing agency generally includes the matching and verification of such transactions. The Commission has taken this process into account in paragraph (e) of Rule 15Fi-2, which exempts SBS Entities from the obligation to provide a trade acknowledgment in clearing transactions. The Commission estimates that of the approximately 2.98

million SBS transactions estimated per year based on the 2015 data, approximately 1.32 million will be clearing transactions excepted from the trade acknowledgment requirement pursuant to paragraph (e) of Rule 15Fi-2. Of the remaining 1.66 million transactions, approximately 75%, or 1.25 million, will be transactions executed on an SBSEF or exchange and thus excepted from the trade acknowledgment requirement pursuant to the exception for in paragraph (f) of Rule 15Fi-2. Thus, we estimate that SBS Entities will have to provide approximately 0.41 million trade acknowledgments pursuant to Final Rule 15Fi-2.

In the Proposing Release, the Commission stated its assumption that most SBS Entities do not currently have the platforms necessary for processing, acknowledging, and verifying SBS transactions electronically, whether internally or by transmitting the necessary data packages to the facilities of a clearing agency for processing. Therefore, the Commission believed that SBS Entities will have to develop OMSs connected or linked to the facilities of a clearing agency and able to process SBS transactions internally if necessary.<sup>237</sup> One commenter agreed that appropriate platforms and processes will need to be developed by the industry, but did not indicate how many SBS Entities will need to develop OMSs or how much they will cost, although the commenter did state that the estimate in the proposing release was too low.<sup>238</sup>

Based on our staff's discussions with industry participants and incorporated in our other rulemaking related to the Dodd-Frank Act,<sup>239</sup> the Commission preliminarily estimated that the development of an OMS for electronic processing of SBS transactions with the capabilities described above would impose a one-time aggregate burden of approximately 19,525 hours, or 355 burden hours per SBS Entity.<sup>240</sup> This

<sup>237</sup> The Commission believes that systems for acknowledging and verifying SBS transactions will likely be an additional functionality of an OMS that SBS Entities will have to use to report SBS transactions to an SBS data repository. See SBSR Proposing Release, *supra* note 31.

<sup>238</sup> ISDA I at 8.

<sup>239</sup> See Proposing Release, 76 FR at 3869.

<sup>240</sup> This estimate is based on Commission staff discussions with market participants and is calculated as follows: [(Sr. Programmer at 160 hours) + (Sr. Systems Analyst at 160 hours) + (Compliance Manager at 10 hours) + (Director of Compliance at 5 hours) + (Compliance Attorney at 20 hours)] x 55 (SBS Entities)] = 19,525 burden hours at 355 hours per SBS Entity. The Commission understands that many SBS Entities may already have computerized systems in place for electronically processing SBS transactions, whether

<sup>233</sup> Rule 15Fi-2(b).

<sup>234</sup> See Rule 15Fi-2(c); see also discussion in Section II.D. *supra*.

<sup>235</sup> See Part VII.B.1 below for additional details.

<sup>236</sup> This figure is based on the following: (2,980,000 estimated SBS transactions)/(55 SBS Entities) = 54,182 SBS transactions per SBS Entity per year. The Commission understands that many of these transactions may arise from previously executed SBS transactions.



estimate assumes that SBS Entities will not have to develop an entirely new OMS but rather would leverage existing trading and processing platforms and adapt those systems to satisfy the functionalities described above. In addition, the Commission further estimated that Rule 15Fi-2 would impose an ongoing annual hour burden of approximately 23,980 hours or 436 hours per SBS Entity.<sup>241</sup> This estimate includes day-to-day technical support of the OMS, as well as the amortized annual burden associated with system or platform upgrades and periodic implementation of significant updates based on new technology, products, or both.

In addition, pursuant to paragraph (d)(1) of Rule 15Fi-2, SBS Entities must establish, maintain, and enforce written policies and procedures reasonably designed to obtain prompt verification of transaction terms. While the burden of these policies and procedures will vary, the Commission estimates that policies and procedures would require an average of 80 hours per respondent to initially prepare and implement, with a total initial burden of 4,400 hours for all respondents.<sup>242</sup> Once these policies and procedures are established, the Commission estimates that it will take an average of 40 hours annually to maintain these policies and procedures per respondent, with a total estimated average annual burden of 2,200 hours for all respondents.<sup>243</sup>

The Commission received one comment on the estimated cost associated with the burden of developing an OMS. That commenter wrote that the estimated cost very seriously underestimated the actual cost, but provided no specific cost estimates.<sup>244</sup> The commenter subsequently stated to Commission staff

internally or through a clearing agency. This may result in lesser burdens for those parties.

<sup>241</sup> This estimate is based on Commission staff discussions with market participants and is calculated as follows: [(Sr. Programmer at 32 hours) + (Sr. Systems Analyst at 32 hours) + (Compliance Manager at 60 hours) + (Compliance Clerk at 240 hours) + (Director of Compliance at 24 hours) + (Compliance Attorney at 48 hours)] x (55 SBS Entities)] = 23,980 burden hours, or 436 hours per SBS Entity.

<sup>242</sup> This estimate is based on Commission staff discussions with market participants and is calculated as follows: [(Compliance Attorney at 40 hours) + (Director of Compliance at 20 hours) + (Deputy General Counsel at 20 hours)] x (55 SBS Entities)] = 4,400 burden hours, or 80 hours per SBS Entity.

<sup>243</sup> This estimate is based on Commission staff discussions with market participants and is calculated as follows: [(Compliance Attorney at 20 hours) + (Director of Compliance at 10 hours) + (General Counsel at 10 hours)] x (55 SBS Entities)] = 2,200 burden hours, or 40 hours per SBS Entity.

<sup>244</sup> ISDA I at 8.

that SBS Entities have now developed OMSs to comply with the CFTC Rule, and the cost of modifying the OMSs to comply with the Commission rule will depend on how closely aligned the Commission rule is to the CFTC Rule.<sup>245</sup> Since the rule the Commission is adopting is much more closely aligned with the CFTC Rule than the proposed rule was, we believe our original estimates do not underestimate the actual cost of the rule as adopted. Therefore, in light of our decision to much more closely align the Commission rule with the CFTC Rule, we believe our estimates remain appropriate.

#### 5. Retention Period of Recordkeeping Requirements

Pursuant to amendments to the Exchange Act from Title VII of the Dodd-Frank Act, the Commission has adopted separate rules for SBS transactions that include, among other things, transaction reporting requirements.<sup>246</sup> The Commission has proposed additional recordkeeping and reporting rules as well.<sup>247</sup> Because a trade acknowledgment will serve as a written record of the transaction, the information required by Rule 15Fi-2 will be required to be maintained by an SBS Entity subject to the proposed rules, if adopted. These requirements are subject to separate PRA submissions under those rulemakings.

#### 6. Collection of Information is Mandatory

Each collection of information discussed above is a mandatory collection of information.

#### 7. Confidentiality

By its terms, information collected pursuant to Rule 15Fi-2 will not be available to the public. Under other Commission rules, however, some of the information required to be included in a trade acknowledgment, as described in paragraph (c) of Rule 15Fi-2, will be otherwise publicly available. In particular, under Regulation SBSR,<sup>248</sup> SBS Entities are required to report certain SBS transaction details to an SBS data repository that will, in turn, publicly disseminate SBS transaction data. To the extent, however, that the Commission receives confidential information pursuant to this collection of information that is otherwise not

publicly available, that information will be kept confidential, subject to applicable law.

#### C. Rule 3a71-6

The amendment to Rule 3a71-6 that we are adopting today amends an existing collection of information.<sup>249</sup> A title and control number already exists for Rule 3a71-6—OMB control number 3235-0715 for “Rule 3a71-6 Substituted Compliance for Foreign Security-Based Swap Entities”—and the Commission will use that control number 3235-0715 for this amended collection of information.

In the Cross Border Proposing Release, the Commission solicited comment on the collection of information requirements and the accuracy of the Commission’s statements. The Commission received no comments on the proposed information collection requirements.

#### 1. Summary of Collection of Information

Rule 3a71-6, as amended, permits security-based swap entities to comply with the Title VII trade acknowledgment and verification requirements by following the comparable regulatory requirements of a foreign jurisdiction. The availability of substituted compliance would be predicated on a determination by the Commission that the relevant foreign requirements are comparable to the requirements that otherwise would be applicable, taking into account the scope and objectives of the relevant foreign requirements,<sup>250</sup> and the effectiveness of supervision and enforcement under the foreign regulatory system.<sup>251</sup> The availability of substituted compliance further would be predicated on there being a supervisory and enforcement MOU or other arrangement between the Commission and the relevant foreign authority addressing oversight and supervision under the substituted compliance determination.<sup>252</sup>

Requests for substituted compliance may come from parties or groups of

<sup>249</sup> See Business Conduct Adopting Release, 81 FR at 30082 (addressing collection of information in connection with adoption of substituted compliance rule for business conduct requirements).

<sup>250</sup> In the specific context of substituted compliance for the trade acknowledgment and verification requirements, prior to making any comparability determination the Commission intends to consider whether the information that is required to be provided to counterparties pursuant to the foreign financial regulatory system’s rules is comparable to what Rule 15Fi-2 requires, and that the foreign system’s rules require trade acknowledgment and verification in a manner and timeframe comparable to what Rule 15Fi-2 requires. See Exchange Act Rule 3a71-6(d)(3).

<sup>251</sup> See Exchange Act Rule 3a71-6(a)(2)(i).

<sup>252</sup> See Exchange Act Rule 3a71-6(a)(2)(ii).

<sup>245</sup> Memorandum from the Division of Trading and Markets regarding a March 4, 2016, conference call with representatives of ISDA.

<sup>246</sup> See SBSR Adopting Release, *supra* note 49.

<sup>247</sup> See SBS Books and Records Proposing Release, *supra* note 128.

<sup>248</sup> See SBSR Adopting Release, *supra* note 49.

parties that may rely on substituted compliance, or from foreign financial authorities supervising such persons' security-based swap activities.<sup>253</sup> Under the final rule, the Commission would make any determinations with regard to the trade acknowledgment and verification requirements, rather than on a firm-by-firm basis. Once the Commission has made a substituted compliance determination, other similarly situated market participants would be able to rely on that determination to the extent applicable and subject to any corresponding conditions. Accordingly, the Commission expects that requests for a substituted compliance determination would be made only where an entity seeks to rely on particular requirements of a foreign jurisdiction that have not previously been the subject of a substituted compliance request. The Commission believes that this approach would substantially reduce the burden associated with requesting substituted compliance determinations for an entity that relies on a previously issued determination, and, therefore, complying with the Commission's rules and regulations more generally.

As provided by Exchange Act Rule 0-13, which the Commission adopted in 2014, applications for substituted compliance determinations in connection with these requirements must be accompanied by supporting documentation necessary for the Commission to make the determination, including information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor and enforce compliance with such rules, and to cite to and discuss applicable precedent.<sup>254</sup>

## 2. Proposed Use of Information

The Commission would use the information collected pursuant to Exchange Act Rule 3a71-6 to evaluate requests for substituted compliance with respect to the trade acknowledgment and verification requirements applicable to security-based swap entities. The requests for substituted compliance determinations are required when a person seeks a substituted compliance determination.

Consistent with Exchange Act Rule 0-13(h), the Commission will publish in

<sup>253</sup> See Exchange Act Rule 3a71-6(c)(1). Such parties or groups of parties may make requests only if each such party is directly supervised by the foreign financial authority. See Exchange Act Rule 3a71-6(c)(2).

<sup>254</sup> See Exchange Act Rule 0-13(e).

the **Federal Register** a notice that that a complete application has been submitted, and provide the public the opportunity to submit to the Commission any information that relates to the Commission action requested in the application.

## 3. Respondents

Under the final rule, applications for substituted compliance in connection with the trade acknowledgment and verification requirements may be filed by foreign financial authorities, or by non-U.S. security-based swap dealers or major security-based swap participants. Consistent with prior estimates, the Commission staff expects that there may be approximately 22 non-U.S. entities that may potentially register as security-based swap dealers, out of approximately 50 total entities that may register as security-based swap dealers.<sup>255</sup> Potentially, all such non-U.S. security-based swap dealers, or some subset thereof, may seek to rely on substituted compliance in connection with these trade acknowledgment and verification requirements.<sup>256</sup>

In practice, the Commission expects that the greater portion of any such requests will be submitted by foreign financial authorities, given their expertise in connection with the relevant substantive requirements, and in connection with their supervisory and enforcement oversight with regard to security-based swap dealers and their activities.

## 4. Total Initial and Annual Reporting and Recordkeeping Burdens

Rule 3a71-6 under the Exchange Act would require submission of certain information to the Commission to the extent security-based swap dealers or major security-based swap participants elect to request a substituted compliance determination with respect to the Title VII trade acknowledgment and verification requirements. Consistent with Exchange Act Rule 0-13, such applications must be

<sup>255</sup> See "Application of the Title VII Security-Based Swap Dealer De Minimis Counting Requirements to Activity in the United States," Exchange Act Release No. 77104 (Feb. 10, 2016), 81 FR 8598, 8605 (Feb. 19, 2016) ("U.S. Activity Adopting Release"); see also Business Conduct Adopting Release, 81 FR at 30090.

<sup>256</sup> Consistent with prior estimates, the Commission staff further believes that there may be zero to five major security-based swap participants. See Registration Adopting Release, 80 FR at 49000; see also Business Conduct Adopting Release, 81 FR at 30090 n.1526. It is possible that some subset of those entities will be non-U.S. major security-based swap participants that will seek to rely on substituted compliance in connection with the trade acknowledgment and verification requirements.

accompanied by supporting documentation necessary for the Commission to make the determination, including information regarding applicable foreign requirements, and the methods used by foreign authorities to monitor and enforce compliance.

The Commission expects that registered security-based swap dealers and major security-based swap participants will seek to rely on substituted compliance upon registration, and that it is likely that the majority of such requests will be made during the first year following the effective date. Requests would not be necessary with regard to applicable rules and regulations of a foreign jurisdiction that have previously been the subject of a substituted compliance determination in connection with the applicable rules.

As we previously discussed in the context of substituted compliance for the business conduct requirements, the Commission expects that the great majority of substituted compliance applications will be submitted by foreign authorities, and that very few substituted compliance requests will come from security-based swap dealers or major security-based swap participants. For purposes of this assessment, the Commission estimates that three such security-based swap entities will submit such applications in connection with the trade acknowledgment and verification requirements.<sup>257</sup> The Commission estimates that the total paperwork burden incurred by such entities associated with preparing and submitting a request for a substituted compliance determination in connection with the trade acknowledgment and verification requirements will be approximately 240 hours, plus \$240,000 for the services of outside professionals for all three requests.<sup>258</sup>

<sup>257</sup> See Business Conduct Adopting Release, 81 FR at 30097.

<sup>258</sup> In the Business Conduct Adopting Release, the Commission stated that consistent with the per-request estimates in the Cross-Border Proposing Release, the Commission estimates that the paperwork burden associated with making each such substituted compliance request would be approximately 80 hours of in-house counsel time, plus \$80,000 for the services of outside professionals (based on 200 hours of outside time \* 400). See Business Conduct Adopting Release, 81 FR at 30097 n.1583; see also Cross-Border Proposing Release, 78 FR at 31110.

In the Business Conduct Adopting Release, the Commission further stated that in practice those amounts may overestimate the costs of requests pursuant to Rule 3a71-6 as adopted, as such requests would solely address the business conduct requirements, rather than the broader proposed scope of substituted compliance set forth in the Cross-Border Proposing Release. See Business

## 5. Collection of Information Is Mandatory

The application for substituted compliance is mandatory for all foreign financial authorities or security-based swap dealers or major security-based swap participants that seek a substituted compliance determination.

## 6. Confidentiality

The Commission generally will make requests for substituted compliance determination public, subject to requests for confidential treatment being submitted pursuant to any applicable provisions governing confidentiality under the Exchange Act.<sup>259</sup>

## VII. Economic Analysis

### A. Introduction

The Commission is adopting final rules under Sections 15F(i)(1) and 15F(i)(2) of the Exchange Act to prescribe standards to provide for timely and accurate confirmation of SBS transactions. The security-based swap market experienced substantial growth in the years prior to the financial crisis; in single-name CDS alone, global notional grew from \$5.1 trillion outstanding in 2004 to a peak of \$33.4 trillion outstanding in mid-2008, a six-fold increase. Multi-name CDS, which may include both SEC-regulated security-based swaps and CFTC-regulated swaps, grew from \$1.3 trillion global notional outstanding in 2004 to a peak of \$25.8 trillion outstanding at year-end 2007.<sup>260</sup> During this period of growth, as highlighted by the Government Accountability Office (“GAO”) Confirmation Report, the credit derivatives industry experienced an unprecedented increase in the backlog of unconfirmed trades, reaching 153,860 unconfirmed trades by the end of September 2005, including 97,650 confirmations outstanding more than 30

days.<sup>261</sup> The GAO viewed the lack of automation and the purported assignment of positions by transferring parties to third parties without notice to their counterparties as the primary factors contributing to this backlog.<sup>262</sup> The GAO also found that if new transactions are left unconfirmed, there is no definitive written record of the contract terms. Thus, in the event of a dispute, the terms of the agreement must be reconstructed from other evidence, such as email trails or recorded trader conversations. The GAO noted that this process is cumbersome and may not be wholly accurate.

Unlike most other securities transactions, a security-based swap gives rise to ongoing obligations between transaction counterparties during the life of the transaction, including payments contingent on specific events, such as a corporate default. Consequently, confirmation of the terms of an SBS transaction is essential for SBS Entities to effectively measure and manage market and credit risk. In addition, unconfirmed trade assignments could create a situation where a market participant has incorrect information about the identity of its counterparty, impairing the proper measurement and management of credit risk, and potentially placing the participant’s financial stability at risk. Finally, a backlog of unconfirmed trades could hinder the settlement process, particularly if errors go undetected or a counterparty disputes the terms of a transaction. In the case of a credit event involving a reference entity with a large notional outstanding and many counterparties, breakdowns in the settlement process that result from unconfirmed trades could lead to broader market instability.

In light of the potential for inefficient risk management and breakdowns in the settlement process, the Federal Reserve Bank of New York initiated a joint regulatory initiative with other regulators in September 2005 to reduce the outstanding backlog of unconfirmed trades. Under this initiative, U.S. and foreign regulators worked with the 14 major credit derivative dealers to reduce

the outstanding backlog of unconfirmed trades.<sup>263</sup> Specific details of the joint regulatory initiative included increasing the use of electronic trade confirmations systems, a protocol for ending unilateral trade assignments, improvements in the settlement process around credit events, and establishment of an electronic trade repository to record and store the terms of all credit derivative transactions. As a result of these efforts, by October 2006, the backlog of unconfirmed trades had fallen to 37,306, a 76% decrease, while the backlog of confirmations outstanding more than 30 days had fallen to 5,558, a 94% decrease.

The need for regulatory coordination to reduce the confirmations backlog highlights a fundamental economic consideration: Though all market participants would benefit from a reduction in unconfirmed trades and the associated market, credit, and settlement risks, no one participant had the ability or incentive to unilaterally take steps to reduce the backlog.<sup>264</sup> Indeed, strategic and competitive considerations among dealers may have contributed to the backlog. According to the GAO Confirmation Report, a major contributing factor to the backlog of unconfirmed trades was the increasing use of unilateral trade assignments.<sup>265</sup> Because assignments are typically less expensive than terminations for hedge funds and other end users, these market participants prefer to transact with dealers that will accept unilateral assignments. Furthermore, assignees are likely to be other dealers. The security-based swap market is a concentrated market, with a small number of dealers responsible for the vast majority of transaction volume. Dealers in this interconnected network rely on each other as counterparties to share and hedge risks associated with lending and other financial intermediation activities. Because assignees are typically counterparties with whom dealers have ongoing financial relationships and are

Conduct Adopting Release, 81 FR at 30097 n.1583. To the extent that a security-based swap dealer submits substituted compliance requests in connection with both the business conduct requirements and the trade acknowledgment and verification requirements, the Commission believes that the paperwork burden associated with the requests would be greater than that associated with a narrower request, given the need for more information regarding the comparability of the relevant rules and the adequacy of the associated supervision and enforcement practices. In the Commission’s view, however, the burden associated with such a combined request would not exceed the prior estimate.

<sup>259</sup> See Cross-Border Definitions Adopting Release, 79 FR at 47359 (discussing confidentiality provisions under the Exchange Act).

<sup>260</sup> Source: BIS, available at <http://www.bis.org/statistics/derstats.htm>.

<sup>261</sup> GAO Confirmation Report at 11. Note that this backlog includes both single-name CDS (SBS) and index CDS (swaps).

<sup>262</sup> Several factors reduced the risk of unconfirmed trades due to unilateral assignment, including: (1) The tendency for end-users to assign contracts to dealers who were generally more credit-worthy than the end-user; (2) dealers refusing to release posted collateral until the dealer verified the assignment, and; (3) a novation protocol in the ISDA Master Agreement that required counterparties to obtain the written consent of their counterparties before assigning a trade. *Id.* at 17–18.

<sup>263</sup> Regulatory representatives from the OCC, SEC, FSA, German Financial Supervisory Authority, and the Swiss Federal Banking Commission attended the initial meeting in September 2005. The participating dealers were Bank of America, Barclays Capital, Bear Stearns, Citigroup, Credit Suisse First Boston, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Lehman Brothers, Merrill Lynch, Morgan Stanley, UBS, and Wachovia. Source: GAO–07–716.

<sup>264</sup> A situation where all market participants would collectively benefit from a certain action—in this case, steps to reduce the backlog of unconfirmed trades—but where no one participant has the incentive to unilaterally take action is commonly known as a “collective action problem.”

<sup>265</sup> According to the report, while assignments accounted for only 13% of dealing activity in September 2005, they accounted for 40% of the unconfirmed backlog outstanding for more than 30 days.

readily familiar, they are less likely to object to unilateral assignments than if the assignee were an unknown credit risk.

The final trade acknowledgment and verification rules are designed to prevent a recurrence of confirmation backlogs that developed during the growth of the credit derivatives market. Although the factors that led to the backlog are not present today, the Commission believes that codifying existing practices may help to prevent a recurrence. More specifically, we note that current practices with respect to security-based swaps that developed out of the joint regulatory initiative are voluntary.<sup>266</sup> Individual dealers facing financial distress, such as a liquidity crunch or cash flow problems, may have incentives to deviate from current practice if, for example, extending dispute periods or delaying confirmation allows a distressed dealer to conserve cash or other financial resources. In addition, the agreement that developed out of the joint regulatory initiative may not cover all market participants that will register with the Commission as SBS Entities. Therefore, we believe that the final trade acknowledgment and verification rules will reduce the likelihood of a recurrence of the confirmation backlog, as well as the market, credit, and settlement risks that accompany a backlog.

In adopting final rules covering trade acknowledgment and verification of security-based swap transactions, we are mindful of the costs imposed by and the benefits obtained from our rules. Section 3(f) of the Exchange Act provides that whenever the Commission is engaged in rulemaking pursuant to the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.<sup>267</sup> In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.<sup>268</sup> Exchange Act Section 23(a)(2) also provides that the

Commission shall not adopt any rule which would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The discussion below addresses the potential economic effects of the final trade acknowledgment and verification rules, including the likely benefits and costs of the rules and their potential impact on efficiency, competition, and capital formation.

#### B. Economic Baseline

To assess the economic impact of the final trade acknowledgment and verification rules, we are using as our baseline the security-based swap market as it exists at this time, including applicable rules we have already adopted but excluding rules that we have proposed but not yet finalized.<sup>269</sup> The analysis includes the statutory and regulatory provisions that currently govern the security-based swap market pursuant to the Dodd-Frank Act, as well as rules adopted in the Intermediary Definitions Adopting Release,<sup>270</sup> the Cross-Border Adopting Release,<sup>271</sup> and the Registration Adopting Release.<sup>272</sup> These foundational rules establish a population of registered entities required to comply with the trade acknowledgment and verification requirements, and therefore establish the overall scope of our final rules.<sup>273</sup> Our understanding of the market is informed by available data on security-based swap transactions, though we acknowledge the data limit the extent to which we can quantitatively characterize the market. Because these data do not cover the entire market, we have developed an understanding of market activity using a sample that includes only certain portions of the market.

Furthermore, the overall Title VII regulatory framework will have consequences for the transaction

activity addressed by these final rules. For example, the final trade confirmation rules include an exception for transactions where the direct counterparty to the trade is a registered clearing agency. Therefore, the scope of future mandatory clearing requirements may affect the overall level of SBS activity subject to the final rules, and therefore the overall costs borne by registered SBS Entities. Similarly, the scope of future mandatory trade execution requirements will affect the volume of transactions that take place on swap execution facilities and other trading platforms; such transactions also have an available exception, which may further reduce the overall trade confirmation costs borne by registered SBS Entities.

#### 1. Available Data on Security-Based Swaps

Our understanding of the security-based swap market is informed in part by available data on security-based swap transactions, though we acknowledge that limitations in the data limit the extent to which we can quantitatively characterize the market. Because these data do not cover the entire market, we have developed an understanding of market activity using a sample of transactions data that includes only certain portions of the market. We believe, however, that the data underlying our analysis here provide reasonably comprehensive information regarding single-name CDS transactions and the composition of participants in the single-name CDS market.

Specifically, our analysis of the state of the current security-based swap market is based on data obtained from the DTCC Derivatives Repository Limited Trade Information Warehouse (“DTCC-TIW”), especially data regarding the activity of market participants in the single-name CDS market during the period from 2008 to 2015. According to data published by the Bank for International Settlements (“BIS”), the global notional amount outstanding in equity forwards and swaps as of June 2015 was \$2.80 trillion. The notional amount outstanding in single-name CDS was approximately \$8.21 trillion, in multi-name index CDS was approximately \$6.91 trillion, and in multi-name, non-index CDS was approximately \$482 billion.<sup>274</sup>

Our analysis here focuses on the data relating to single-name CDS. As the BIS

<sup>266</sup> The backlog of unconfirmed credit derivative transactions that developed prior to the financial crisis encompassed both CFTC-regulated swaps and SEC-regulated security-based swaps. The CFTC has promulgated final rules with respect to trade confirmations of swaps; while the joint regulatory initiative covered both swaps and security-based swaps, only practices with respect to security-based swaps remain voluntary.

<sup>267</sup> 15 U.S.C. 78c(f).

<sup>268</sup> 15 U.S.C. 78w(a)(2).

<sup>269</sup> We also considered, where appropriate, the impact of rules and technical standards promulgated by other regulators, such as the CFTC and the European Securities and Markets Authority, on practices in the security-based swap market.

<sup>270</sup> 77 FR 30596 (May 23, 2012).

<sup>271</sup> 79 FR 47277 (August 12, 2014).

<sup>272</sup> 80 FR 48963 (August 14, 2015).

<sup>273</sup> In addition, in Regulation SBSR, the Commission has also adopted final reporting and public dissemination rules under Title VII. These and forthcoming substantive requirements of Title VII may affect how firms structure their security-based swap business and market practices more generally, which could have additional implications for the scope of final trade confirmation rules. If SBS Entities operating globally are able to structure their business along jurisdictional lines, greater or fewer transactions may be covered by final trade confirmation rules, depending on whether entities move business in or out of the Title VII framework.

<sup>274</sup> See Semi-annual OTC derivatives statistics at June 2015, Tables D8 and D10.1, available at <http://www.bis.org/statistics/d8.pdf> and [http://www.bis.org/statistics/d10\\_1.pdf](http://www.bis.org/statistics/d10_1.pdf) (accessed February 9, 2016).

figures show (and as we have previously noted), although the definition of security-based swap is not limited to single-name CDS, single-name CDS contracts make up a majority of security-based swaps, and we believe that the single-name CDS data are sufficiently representative of the market and therefore can directly inform the analysis of the state of the current security-based swap market.<sup>275</sup> We note that the data available to us from TIW do not encompass those CDS transactions that both: (i) Do not involve U.S. counterparties;<sup>276</sup> and (ii) are based on non-U.S. reference entities. Notwithstanding this limitation, we believe that the TIW data provide sufficient information to identify the types of market participants active in the security-based swap market and the general pattern of dealing within that market.<sup>277</sup>

## 2. Current Security-Based Swap Market

In 2015, there were 2,436,531 single-name CDS transactions reported to TIW, of which 1,080,716 were transactions with a clearing agency as a counterparty.<sup>278</sup> Currently, SBS

<sup>275</sup> While other repositories may collect data on transactions in total return swaps on equity and debt, we do not currently have access to such data for these products (or other products that are security-based swaps). In the Cross-Border Proposing Release, we explained that we believed that data related to single-name CDS was reasonable for purposes of this analysis, as such transactions appear to constitute roughly 82% of the security-based swap market as measured on a notional basis. See Cross-Border Proposing Release, footnote 1301 at 31120. No comments disputed these assumptions, and we therefore continue to believe that, although the BIS data reflect the global OTC derivatives market, and not just the U.S. market, these ratios are an adequate representation of the U.S. market.

Also consistent with our approach in that release, with the exception of the analysis regarding the degree of overlap between participation in the single-name CDS market and the index CDS market (cross-market activity), our analysis below does not include data regarding index CDS as we do not currently have sufficient information to identify the relative volumes of index CDS that are swaps or security-based swaps.

<sup>276</sup> We note that DTCC-TIW's entity domicile determinations may not reflect our definition of "U.S. person" in all cases. Our definition of "U.S. person" follows the Cross-Border Adopting Release, at 47303.

<sup>277</sup> The challenges we face in estimating measures of current market activity stem, in part, from the absence of comprehensive reporting requirements for security-based swap market participants. The Commission has adopted rules regarding trade reporting, data elements, and public reporting for security-based swaps that are designed, when fully implemented, to provide the Commission with additional measures of market activity, which should allow us to better understand and monitor activity in the security-based swap market. See SBSR Adopting Release, 80 FR at 14699-700.

<sup>278</sup> For the purposes of this analysis, we assume there were approximately 2.44 million single-name CDS transactions in 2015, of which approximately

transactions are negotiated and executed bilaterally, typically with a dealer as one of the counterparties. Indeed, based on our analysis of TIW data, 84.1% of single-name CDS transactions between 2006 and 2015, as measured by number of transaction-sides, were executed by ISDA-recognized dealers, and greater than 50% of transactions are between two ISDA-recognized dealers.<sup>279</sup>

Further analysis of the data reveals that approximately half of all trading activity in North American single-name CDS between 2008 and 2015 was between counterparties domiciled in the United States and counterparties domiciled abroad. Using the self-reported registered office location of the TIW accounts as proxy for domicile, the Commission estimates that only 12 percent of the global transaction notional volume between 2008 and 2015 was between two U.S.-domiciled counterparties, compared to 48 percent entered into between one U.S.-domiciled counterparty and a foreign-domiciled counterparty and 40 percent entered into between two foreign-domiciled counterparties.<sup>280</sup>

1.08 million were transactions with a clearing agency as a counterparty. In addition to CDS, security-based swap products include equity swaps, such as total return swaps on single names and narrow-based security indexes. The Commission currently lacks comprehensive data on equity swaps, including data on transaction volumes and notional amounts. While there were greater than 2.44 million security-based swap transactions in 2015, we do not currently have sufficient information to precisely identify the number of transactions beyond those that were single-name CDS. However, while recognizing that average notional transaction amounts for equity and multi-name credit default swaps may differ from average notional transaction amounts for CDS, assuming that average notional transaction amounts are in fact equal across all SBS products, our estimate that single-name CDS constitute roughly 82% of the security-based swap market implies that there were approximately 540,000 security-based swap transactions in 2015 in addition to the approximately 2.44 million single-name CDS transactions we identify in the DTCC-TIW data, or 2.98 million total SBS transactions.

<sup>279</sup> For the purpose of this analysis, the ISDA-recognized dealers are those identified by ISDA as belonging to the G14 or G16 dealer group during the period: JP Morgan Chase NA (and Bear Stearns), Morgan Stanley, Bank of America NA (and Merrill Lynch), Goldman Sachs, Deutsche Bank AG, Barclays Capital, Citigroup, UBS, Credit Suisse AG, RBS Group, BNP Paribas, HSBC Bank, Lehman Brothers, Société Générale, Credit Agricole, Wells Fargo and Nomura. See, e.g., [http://www.isda.org/c\\_and\\_a/pdf/ISDA-Operations-Survey-2010.pdf](http://www.isda.org/c_and_a/pdf/ISDA-Operations-Survey-2010.pdf).

<sup>280</sup> The domicile classifications in TIW data are based on the market participants' own reporting and have not been verified by Commission staff. Prior to enactment of the Dodd-Frank Act, account holders did not formally report their domicile to the TIW because there was no systematic requirement to do so. After enactment of the Dodd-Frank Act, the TIW has collected the registered office location of the account. This information is self-reported on a voluntary basis, and it is possible that some market participants may misclassify their domicile status because the databases in TIW do not assign

When the domicile of TIW accounts is instead defined according to the domicile of an account holder's ultimate parents, headquarters, or home offices (e.g., classifying a foreign bank branch or foreign subsidiary of a U.S. entity as domiciled in the United States), the fraction of transactions entered into between two U.S.-domiciled counterparties increases to 33 percent, and to 52 percent for transactions entered into between a U.S.-domiciled counterparty and a foreign-domiciled counterparty.

## 3. Current Estimates of Number of SBS Dealers and Major SBS Participants

Under the final rules, registered SBS Entities will be required to provide trade acknowledgments to their counterparties, and will also be required to have policies and procedures in place reasonably designed to ensure prompt receipt of trade verifications from their counterparties. In addition, when receiving a trade acknowledgment from another entity, registered SBS Entities will be required to promptly verify or dispute the terms of a trade acknowledgment with its counterparty. The Commission recently adopted final registration requirements for SBS Entities<sup>281</sup> and expects market participants meeting the registration thresholds outlined in the Intermediary Definitions and Cross-Border Adopting Releases to register with the Commission once substantive Title VII requirements that trigger registration compliance are adopted. We anticipate that 50 entities meeting registration thresholds for SBS dealers will seek to register with the Commission.

As noted in the U.S. Activity Adopting Release, based on an analysis of TIW data, out of more than 4,000 entities engaged in single-name CDS activity worldwide in 2015, 104 entities engaged in relevant single-name CDS activity at a sufficiently high level that they would be expected to incur assessment costs to determine whether they meet the "security-based swap dealer" definition.<sup>282</sup> Approximately 47 of these entities are non-U.S. persons. Analysis of those data further indicated that potentially 50 entities may engage in dealing activity that would exceed

a unique legal entity identifier to each separate entity. It is also possible that the domicile classifications may not correspond precisely to the definition of "U.S. person" under the rules defined in Exchange Act Rule 3a71-3(a)(4), 17 CFR 240.3a71-3(a)(4). Notwithstanding these limitations, the Commission believes these statistics demonstrate the extent of cross-border activity in the single-name CDS market.

<sup>281</sup> 80 FR 48963.

<sup>282</sup> See U.S. Activity Adopting Release, *supra* note 255, 81 FR at 8605.

the *de minimis* threshold, and thus ultimately have to register as SBS Dealers. Of these entities, we believe it is reasonable to expect 22 to be non-U.S. persons.<sup>283</sup> The Commission also undertook an analysis of the number of security-based swap market participants likely to register as major security-based swap participants, and estimated a range of between zero and five such participants.<sup>284</sup>

In addition, in the proposed registration requirements for SBS Dealers and Major SBS Participants, we estimated, based on our experience and understanding of the swap and security-based swap markets, that of the 55 firms that might register as SBS Dealers or Major SBS Participants, approximately 35 would also register with the CFTC as swap dealers or major swap participants.<sup>285</sup> Available data suggest that these numbers remain largely unchanged.<sup>286</sup>

#### 4. Trade Execution

The Commission has not yet finalized mandatory trade execution requirements or made available to trade determinations, and currently there are no security-based swap execution facilities registered with the Commission; security-based swaps continue to be negotiated and executed almost exclusively on a bilateral basis. Therefore, while the final trade confirmation rules contain an exception for transactions executed on a swap execution facility or national securities

exchange, none of the approximately 2.98 million security-based swap transactions that executed in 2015 would have been eligible for this exception.

In the absence of SEF-executed SBS trades, we use data on index CDS transactions executed on CFTC-registered swap execution facilities to estimate the number of SBS transactions that may become eligible for the exception for SEF-executed transactions. Specifically, we rely on data tabulated by ISDA and published in the SwapsInfo Fourth Quarter 2015 Review.<sup>287</sup> Based on these data, we estimate that approximately 75% of index CDS transactions were executed on a SEF in 2015.

Applying this percentage to the number of single-name CDS transactions we identify in 2015 suggests that as many as 1.02 million single-name CDS transactions could be eligible for this exception assuming that mandatory trade execution rules come into force.<sup>288</sup> We believe this estimate is an appropriate approach because single-name and index CDS are similar products that allow market participants to buy and sell default risk: A default event for a reference entity that is an index component will result in payoffs on both single-name CDS written on the reference entity and index CDS written on indices that contain the reference entity. Because of this relationship between the payoffs of single-name and index CDS products, prices of these products depend upon one another, creating hedging opportunities across these markets.<sup>289</sup> These hedging opportunities mean that participants

that are active in one market are likely to be active in the other. The Commission therefore believes that, in order to attract participants seeking to transact across swap and SBS markets, SEFs may seek dual registration status with both the Commission and the CFTC, with authorization to provide markets for both index and single-name CDS. Thus, we expect that once the Commission has adopted rules for SEFs, index and single-name CDS may trade on the same execution facilities.

Nevertheless, there are reasons to believe that a greater percentage of SBS transactions will continue to be executed bilaterally. The Commission believes that index CDS products are more likely to be standardized products, used for common hedging scenarios. SBS products, on the other hand, are more likely to be bespoke products, customized for the unique hedging requirements of a particular counterparty. Therefore, we consider our estimate of SBS transactions eligible for the SEF exception to be an upper bound; the actual number of platform-executed SBS transactions could be considerably lower.

#### 5. Clearing Activity

The Commission has not yet made mandatory clearing determinations; currently, security-based swaps are cleared on a voluntary basis. As we noted above, out of the 2.44 million single-name CDS transactions in 2015, 1.08 million, or approximately 44%, were transactions with a clearing agency as a counterparty. Under the final rules, these transactions would be eligible for an exception from trade confirmation requirements.

If the Commission were to make mandatory clearing determinations, we believe that a greater percentage of transactions could be centrally cleared, and therefore eligible for an exception from trade confirmation requirements. To estimate the potential of such transactions, we again look to data on index CDS transactions tabulated in ISDA's SwapsInfo Fourth Quarter 2015 Review, which suggests that approximately 79% of index CDS transactions were centrally cleared in 2015. Based on these data, as many as 1.93 million single-name CDS transactions could be eligible for an exception from trade confirmation requirements based on clearing status.<sup>290</sup>

<sup>283</sup> These estimates are based on the number of accounts in DTCC-TIWI data with total notional volume in excess of *de minimis* thresholds, increased by a factor of two, to account for any potential growth in the security-based swap market, to account for the fact that we are limited in observing transaction records for activity between non-U.S. persons that reference U.S. underliers, and to account for the fact that we do not observe security-based swap transactions other than in single name CDS. See Cross Border Dealing Activity Proposing Release, 80 FR at 27452; see also Intermediary Definitions Adopting Release, footnote 1457 at 30725.

<sup>284</sup> See SBSR Adopting Release 14693; see also Cross-Border Adopting Release, footnotes 150 and 153 at 47296 and 47297 (describing the methodology employed by the Commission to estimate the number of potential SBS Dealers and Major SBS Participants).

<sup>285</sup> See Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 65543 (Oct. 12, 2011), 76 FR 65784, 65808 (Oct. 24, 2011).

<sup>286</sup> Based on our analysis of 2015 DTCC-TIWI data and the list of swap dealers provisionally-registered with the CFTC, and applying the methodology used in the Intermediary Definitions Adopting Release, we estimate that substantially all registered security-based swap dealers would also register as swap dealers with the CFTC. See Cross Border Dealing Activity Proposing Release, at 27458; see also CFTC list of provisionally registered swap dealers, available at <http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer>.

<sup>287</sup> Source: ISDA, available at <http://www2.isda.org/functional-areas/research/research-notes/>. ISDA bases its analysis on public index CDS data disseminated by DTCC and Bloomberg swap data repositories.

<sup>288</sup> To arrive at this number, we first back out 1.08 million clearing transactions from 2.44 million total CDS transactions. This yields 1.36 million original bilateral transactions. Multiplying this by 0.75 yields 1.02 million platform-executed transactions. To account for non-CDS security-based swaps, we again rely on our estimate that single-name CDS represent 82% of the total SBS market. We also assume that ratio of cleared to non-cleared transactions is the same across all security-based swaps. This implies that, of the estimated 2.98 million SBS transactions in 2015, 1.32 million were clearing transactions, which yields 1.66 million original bilateral SBS transactions. Finally, making the further assumption that the percentage of transactions executed on a SEF will also be the same across all security-based swaps suggests that as many as 1.25 million SBS transactions could be eligible for the exception for SEF-executed transactions.

<sup>289</sup> "Correlation" typically refers to linear relationships between variables; "dependence" captures a broader set of relationships that may be more appropriate for certain swaps and security-based swaps. See, e.g., Casella, George and Roger L. Berger, "Statistical Inference" (2002), at 171.

<sup>290</sup> Assuming that the ratio of cleared to non-cleared transactions is the same across all security-based swaps, we estimate that as many as 2.35 million SBS transactions could be eligible for an exception from trade confirmation requirements based on clearing status. [(2.98 million total SBS

However, for the same reasons as with platform-executed trades, the Commission believes it is plausible that a greater percentage of SBS transactions will continue to be executed on a bilateral basis. Because SBS products are more likely than index CDS products to be bespoke, we believe it is plausible that there will be a larger percentage of bespoke products that will not be accepted for clearing at registered clearing agencies. Therefore, we consider this estimate of SBS transactions eligible for a clearing exception to be an upper bound; as with platform-executed transactions, the number of cleared SBS transactions could be considerably lower than 1.93 million.

#### 6. Current Trade Confirmation Practices

As highlighted above, various voluntary and regulatory initiatives to establish trade confirmation practices are underway in multiple jurisdictions, including the joint regulatory initiative, CFTC requirements for swap transactions, and ESMA requirements. Given the significant amount of cross-market and cross-border activity, many of the market participants active in the domestic security-based swap market are also active in the domestic swap market and foreign swap and security-based swap markets. Therefore, many of the market participants expected to register as SBS Entities may already be complying with voluntary or required trade confirmation practices, either as participants in the joint regulatory initiative, or as registered participants in another regulatory jurisdiction. We describe these practices in more detail below.

##### a. Joint Regulatory Initiative

As described above, in order to reduce the outstanding confirmations backlog, as well as the risks associated with the backlog, the Federal Reserve Bank of New York initiated a joint regulatory initiative with other regulators, including the Commission, in September 2005. Under this voluntary arrangement, participating dealers, including the ISDA-recognized dealers, provide electronic trade confirmations to their counterparties through DTCC's Deriv/SERV platform. In addition, trades confirmed through Deriv/SERV are automatically stored in the DTCC-TIW trade repository.<sup>291</sup>

transactions) × (79% centrally cleared) = 2.35 million cleared transactions.]

<sup>291</sup> The final rule does not restrict the use of third-party confirmation providers, consistent with the current practice of relying on DTCC to provide confirmations.

The Commission understands that most of the entities expected to register as dealers are already providing electronic trade confirmations. Our understanding is based on data provided in the 2013 ISDA Operations Benchmarking Survey, the most recent survey available, covering transaction activity that occurred during the 2012 calendar year.<sup>292</sup> According to the survey, 98% of credit derivative transaction volume is eligible for electronic confirmation, with nearly 100% of eligible volume confirmed electronically.<sup>293</sup> However, the survey indicates that the majority of equity derivative transaction volume in 2012 was confirmed by means other than electronic communication. Only 30% of equity derivative transaction volume was confirmed electronically; an additional 10% was eligible for electronic confirmation but confirmed by non-electronic means, while 60% of transaction volume was not eligible for electronic confirmation.<sup>294</sup>

The ISDA survey further states that approximately 75% of electronically confirmed credit derivatives and 50% of electronically confirmed equity derivatives are confirmed on the same day as the transaction, with nearly 100% of electronically confirmed volume confirmed within one day. Non-electronic confirmation generally takes longer: Only 10% of transaction volume is confirmed on the transaction day, while approximately 50% of transaction volume is confirmed within two days. For non-electronic confirmations, the ISDA survey shows that it takes approximately 10 days for 100% of equity and credit derivative transactions to be confirmed.<sup>295</sup>

Finally, the ISDA survey provides some insight into the level of outstanding trade confirmations. Specifically, ISDA expresses outstanding confirmations as business days of activity, which is the ratio of average daily outstanding confirmations to average daily transaction volume.

<sup>292</sup> Source: ISDA, available at <http://www2.isda.org/functional-areas/research/research-notes/>.

<sup>293</sup> ISDA defines electronically eligible as, "Transactions that are eligible for matching on an industry recognized platform, e.g. DTCC, MarkitWire." See 2013 ISDA Operations Benchmarking Survey, page 28.

<sup>294</sup> Source: 2013 ISDA Operations Benchmarking Survey, Table 3.1. Note that the equity derivatives category in the survey may include equity derivatives that do not meet the definition of 'security-based swap,' such as equity forwards, equity futures, and equity options. The survey lacks more-refined data that would allow us to differentiate between equity swaps and non-SBS equity derivatives.

<sup>295</sup> Source: 2013 ISDA Operations Benchmarking Survey, Charts 3.1 and 3.2.

Using this methodology, ISDA estimates that outstanding credit derivative confirmations account for 0.3 business days of activity, with essentially no confirmations outstanding for greater than 30 days.<sup>296</sup> In other words, on any given trading day, the number of outstanding credit derivative confirmations is less than one day's worth of transaction volume, which is broadly consistent with ISDA's findings on confirmation timing. However, as described above, equity derivatives generally take longer to be confirmed than credit derivatives, possibly due to fewer transactions that are eligible for electronic confirmation. As a result, on any given trading day, the amount of outstanding equity derivative confirmations accounts for 4.9 days of transaction volume. In addition, confirmations outstanding for greater than 30 days account for 0.5 days of transaction volume, while confirmations outstanding for greater than 60 days account for 0.1 days of transaction volume.

##### b. CFTC Trade Confirmation Rules

As discussed above, of the 55 entities that may register with the Commission as SBS Entities, we expect that up to 35 may also register with the CFTC as either swap dealers or major swap participants. The CFTC adopted final trade confirmation rules in September 2012 and, as in the Commission's final rule, requires registered swap dealers and major swap participants to provide trade acknowledgments to their counterparties within one business day following the trade execution date. When the counterparty is also a registered entity, the CFTC's final rules require a complete confirmation (acknowledgment and signed verification) within one business day.

In addition, the CFTC's rules require swap dealers and major swap participants to establish and follow written policies and procedures reasonably designed to ensure that they execute a complete trade confirmation within one business day following the trade execution date for financial entity counterparties, and within two business days following the trade execution date for non-financial entity counterparties.<sup>297</sup>

Finally, registered swap dealers and major swap participants are not required

<sup>296</sup> Source: 2013 ISDA Operations Benchmarking Survey, Chart 3.3.

<sup>297</sup> The CFTC's final rule defines a financial entity as one of the following: (1) A commodity pool, (2) a private fund, (3) an employee benefit plan, (4) a bank or financial institution, or (5) a security-based swap dealer or major security-based swap participant.

to provide trade acknowledgments and trade confirmations for swaps that are executed on a swap execution facility (“SEF”) or submitted for clearing with a derivatives clearing organization (“DCO”), provided that the rules of the SEF or DCO require confirmation at the time of trade execution (in the case of a SEF) or at the time the swap transaction is accepted for clearing (in the case of a DCO).

### c. Foreign Trade Confirmation Rules

The European Commission has established trade confirmation rules as part of the European Union’s European Markets Infrastructure Regulation (“EMIR”). These rules define a trade confirmation as either electronic or signed documentation of agreement between the counterparties to a trade on all terms of the transaction. As with the CFTC confirmation rules, EMIR confirmation rules distinguish between financial and non-financial counterparties.

For transactions between financial counterparties, trades must be confirmed as soon as possible but no later than the end of the first business day following the trade execution date. For transactions that involve at least one non-financial counterparty, confirmation rules depend on whether the non-financial counterparty’s OTC derivatives portfolio is above EMIR’s clearing threshold. For CDS and equity swaps, the clearing threshold is EUR 1 billion in gross notional, excluding hedging contracts and other risk-reducing transactions. If a non-financial counterparty has total positions exceeding the clearing threshold, it must confirm trades as soon as possible but no later than the end of the first business day following trade execution. If a non-financial counterparty does not exceed the clearing threshold, it must confirm trades as soon as possible but no later than the end of the second business day following trade execution.

#### *C. Benefits, Costs, and Effects on Efficiency, Competition, and Capital Formation*

As discussed above, the Commission believes that the primary economic benefits of the final rules flow through reduced likelihood of a recurrence in the backlog of unconfirmed trades, as well as reductions in market, credit, settlement, and financial stability risks that accompany a backlog. We also note that economic costs accrue primarily to those potential registrants not already complying with either the CFTC’s trade confirmation rules or the voluntary arrangement established through the joint regulatory initiative. Indeed, for

market participants already active as security-based swap dealers, several of the economic effects described below only occur to the extent that final rules do not conform to existing practices or other regulatory regimes.

Furthermore, while trade confirmations are the responsibility of registered SBS Entities, market, credit, and settlement risks that accompany a confirmations backlog are not limited to registered entities, but rather impact all market participants and have the potential to contribute to broader market instability, as described below. Therefore, while registered SBS Entities bear the costs of the final rules, we expect the risk-reduction benefits of the rules to accrue to all SBS market participants, including both registered and unregistered participants.

In this section we first discuss the expected effects of the final rules on efficiency, competition, and capital formation, focusing particularly on the risk-mitigation benefits that stem from timely and accurate trade confirmations and a reduced likelihood of a recurrence in the backlog of unconfirmed trades. We also discuss the effects of the substituted compliance provisions on efficiency, competition, and capital formation. We then turn our discussion to additional costs and benefits, including compliance costs, which accrue to registered and unregistered market participants, as well as additional costs and benefits related to the availability of substituted compliance. Finally, we close this section with a discussion of the costs and benefits of the exemption for clearing transactions and for exchange and SEF transactions.

#### 1. Effects on Efficiency, Competition, and Capital Formation

Final trade acknowledgment and verification rules have the potential to affect efficiency, competition, and capital formation in the security-based swap market, primarily through a reduction in market, credit, and settlement risks that accompany unconfirmed transactions. In addition, the substituted compliance framework may provide additional effects that are distinct from the broader market impacts that are described below. As with the benefits and costs, we believe that several of the effects described below only occur to the extent that current market practices do not already conform to our final rules.

##### a. Broad Market Effects

As described above, delays in the acknowledgment and verification of trades may cause errors and disputes

over the terms of a transaction to go undetected, leading to errors in measurement and management of market and credit risks associated with particular transactions. More generally, timely acknowledgment and verification of security-based swap transactions will provide counterparties with accurate information that will enable them to evaluate their own risk exposure in a timely manner. Efficient and cost-effective risk management may conserve resources and free up capital that can be deployed in other asset classes, promoting risk-sharing and efficient capital allocation. In addition, cost-effective risk management may reduce the overall costs of financial intermediation, allowing market participants to increase lending and other capital formation activities.

Similarly, improvements in the settlement process that come from timely and accurate trade confirmations may contribute to broader market stability, particularly during periods of distress. As described above, a backlog of unconfirmed trades could hinder timely and efficient settlement of SBS transactions, particularly in the case of a credit event on a reference entity with a large notional outstanding and many counterparties. During periods of financial distress, failure to settle transactions in a timely manner could contribute to liquidity and cash shortfalls that threaten the stability of the financial system. Thus, to the extent that the final rules prevent a recurrence of the confirmation backlog, we expect reduced risk of settlement frictions and associated liquidity shortfalls.

Finally, to the extent that final trade confirmation requirements differ from current market practices, the final rules have the potential to affect competition across multiple dimensions. If the costs of acknowledging and verifying SBS transactions are largely fixed (*i.e.*, the costs come from establishing infrastructure and systems necessary to provide confirmations) rather than varying with the number of transactions confirmed, smaller dealers intermediating a smaller number of trades may have a larger burden placed on them; larger dealers, on the other hand, may be able to spread the costs over a greater number of trades, with a lower average cost of providing confirmations. Similarly, the costs of establishing an infrastructure to provide electronic trade acknowledgments may create a barrier to entry for market participants wishing to establish a security-based swap dealer business.

At the same time, SBS Entities may find it advantageous to compete over transaction acknowledgment and



verification speed. That is, timely and accurate trade confirmation may allow market participants to better manage their market and cash flow risks, improving the efficiency and cost-effectiveness of hedging; as a result, market participants may be encouraged to enter into transactions with SBS Entities whose automated operations reduce the time it takes to acknowledge the terms of the trade.

#### b. Substituted Compliance

As discussed above, if the Commission has made a positive substituted compliance determination with respect to a particular foreign regulatory regime, registered foreign SBS Entities subject to that regulatory regime may be able to satisfy their Title VII trade acknowledgment and verification requirements by alternatively complying with trade confirmation requirements of the foreign jurisdiction. Substituted compliance would be potentially available for registered SBS Entities who are not U.S. persons with respect to all of their security-based swap business.

The Commission is adopting rules to permit consideration of substituted compliance in order to minimize the likelihood that security-based swap dealers are subjected to potentially duplicative or conflicting regulation. The Commission believes that duplicative regulations that achieve comparable regulatory outcomes increase the compliance burdens on market participants without corresponding increases in benefits. By decreasing the compliance burden for foreign SBS dealers active in the U.S. market, the availability of substituted compliance could encourage foreign firms' participation in the U.S. market, increasing the ability of U.S. firms to access global liquidity, and reducing the likelihood that liquidity would fragment along jurisdictional lines. Thus, the availability of substituted compliance for non-U.S. SBS Entities may help promote market efficiency and enhance competition in U.S. markets. In particular, participation by non-U.S. firms and access to liquidity for U.S. firms should promote efficient hedging and sharing of risks among market participants and might result in increased competition between both U.S. and foreign intermediaries without compromising the regulatory benefits intended by the applicable trade confirmation rules.

#### 2. Costs and Benefits to Registered SBS Entities

Under the final rule, a registered SBS Entity is required to provide an

electronic trade acknowledgment to its counterparty, including all terms of the transaction, no later than the end of the first business day following the day of trade execution.<sup>298</sup> In addition, an SBS Entity must promptly verify trade acknowledgments it receives from another SBS Entity or dispute its terms, and have policies and procedures in place reasonably designed to ensure prompt acknowledgment and verification of transactions from counterparties. Finally, an SBS Entity may rely on a third-party of its choosing, including—but not limited to—a clearing agency or swap execution facility, to provide trade acknowledgments.

As noted above, the Commission estimates that up to 50 entities may register with the Commission as SBS dealers, and up to 5 additional entities may register as major SBS participants. We note that many of these entities may already have platforms and systems necessary to provide acknowledgments and verifications, either because they are operating under the framework established by the joint regulatory initiative, or because they are already complying with the CFTC's trade confirmation rules. However, we expect that certain entities that cannot already satisfy the requirements of the final rules, including new entrants, will incur costs to establish necessary systems to provide electronic trade acknowledgments.

To fulfill the proposed rule's requirements, the Commission believes that SBS Entities would have to develop an OMS with portals to relevant clearing agencies and real-time or near real-time linkages between an SBS Entities' front and back-office operations. An SBS Entity would have to develop an OMS regardless of whether an SBS transaction is, or can be, cleared by a clearing agency.

The Commission estimates that an SBS Entity's development of an OMS that achieves compliance with Rule 15Fi-2 would impose a one-time aggregate cost of \$5,315,750,<sup>299</sup> or

<sup>298</sup> In the case of a transaction between a registered SBS dealer and a registered major SBS participant, the SBS dealer must provide the trade acknowledgment. For transactions between two SBS dealers or two major SBS participants, the counterparties must come to an agreement on which counterparty will provide the trade acknowledgment and which counterparty will provide the trade verification.

<sup>299</sup> This estimate is based on the following: [(Sr. Programmer (160 hours) at \$285 per hour) + (Sr. Systems Analyst (160 hours) at \$251 per hour) + (Compliance Manager (10 hours) at \$294 per hour) + (Director of Compliance (5 hours) at \$426 per hour) + (Compliance Attorney (20 hours) at \$291 per hour) × (55 SBS Entities)] = \$5,315,750 or \$96,650 per SBS Entity. The Commission

approximately \$96,650 per SBS Entity. This estimate includes the development of an OMS that leverages off of an SBS Entity's existing front-office and back-office operational platforms. The Commission further estimates that the requirements of Rule 15Fi-2 would impose an ongoing annual aggregate cost of \$4,022,920, or approximately \$73,144 per SBS Entity.<sup>300</sup> This estimate would include day-to-day technical supports of the OMS, as well as an estimate of the amortized annual burden associated with system or platform upgrades and periodic "re-platforming" (*i.e.*, implementing significant updates based on new technology, products, or both). In addition, the Commission estimates that the development and implementation of written policies and procedures as required under paragraph (d)(1) of Final Rule 15Fi-2 would impose initial costs of \$1,754,500, or approximately \$31,900 per SBS Entity.<sup>301</sup> Once established, the Commission estimates that it would cost respondents approximately \$877,250 per year, or \$15,950 per respondent,<sup>302</sup> to update and maintain these policies and procedures.

In sum, the Commission estimates that the initial cost of complying with Rule 15Fi-2 will be \$7,070,250 for all respondents, or \$128,550 per SBS Entity.<sup>303</sup> The Commission estimates that total ongoing costs to respondents would be \$4,900,170 for all respondents, or \$89,094 per SBS

Entity. The Commission understands that many SBS Entities may already computerized systems in place for electronically processing SBS transactions, whether internally or through a clearing agency.

<sup>300</sup> This estimate is based on Commission staff discussions with market participants and is calculated as follows: [(Sr. Programmer (32 hours) at \$285 per hour) + (Sr. Systems Analyst (32 hours) at \$251 per hour) + (Compliance Manager (60 hours) at \$294 per hour) + (Compliance Clerk (240 hours) at \$59 per hour) + (Director of Compliance (24 hours) at \$426 per hour) + (Compliance Attorney (48 hours) at \$291 per hour) × (55 SBS Entities)] = \$4,022,920, or \$73,144 per SBS Entity.

<sup>301</sup> This estimate comes from Commission staff experience regarding the development of policies and procedures and is calculated as follows: [(Compliance Attorney (40 hours) at \$294 per hour) + (Director of Compliance (20 hours) at \$426 per hour) + (Deputy General Counsel (20 hours) at \$581 per hour) × (55 SBS Entities)] = \$1,754,500 total, or \$31,900 per SBS Entity.

<sup>302</sup> This estimate comes from Commission staff experience regarding the updating and maintenance of policies and procedures and is calculated as follows: [(Compliance Attorney (20 hours) at \$294 per hour) + (Director of Compliance (10 hours) at \$426 per hour) + (Deputy General Counsel (10 hours) at \$581 per hour) × (55 SBS Entities)] = \$877,250 total, or \$15,950 per SBS Entity.

<sup>303</sup> (\$5,315,750 initial cost for developing OMS) + (\$1,754,500 for developing policies and procedures) = \$7,070,250 for all respondents. (\$7,070,250/55 Respondents) = \$128,550 per SBS Entity.

Entity.<sup>304</sup> We note, however, that these estimates are grounded in the assumption that each registered entity must establish the necessary systems to comply with the final rules. If potential registrants already have systems in place that would allow them to comply with the rules, either because they participate in the joint regulatory initiative or are registered with the CFTC and comply with their trade confirmation rules, these assessments may over-estimate the aggregate cost to registered SBS Entities of complying with Rule 15Fi-2.

In addition to compliance costs, we expect several additional economic costs and benefits to accrue to registered SBS Entities. Many of these costs and benefits flow from policy choices designed to ease the overall compliance burden. For example, the final rule does not restrict the ability of SBS Entities to rely on third parties, including—but not limited to—clearing agencies and swap execution facilities, to provide trade confirmations. This rule should reduce the overall compliance burden by allowing SBS Entities to leverage existing infrastructure of certain third-party entities that already provide this service.<sup>305</sup>

Similarly, the Commission is not prescribing means or standards for electronic communications; only providing that paper acknowledgments are not in conformance with the rule. We expect that, due to network externalities, the market will conform to a common standard for transmitting trade acknowledgments, such as FpML or FIXML. However, smaller counterparties with low levels of SBS activity may not have the infrastructure in place to receive electronic communications in FpML or FIXML format; the ability for SBS Entities to transmit electronic communications to these counterparties in other formats may increase flexibility and thereby generate cost savings compared with using the FpML or FIXML formats.

Finally, we noted at the outset that reductions in the trade confirmations backlog that developed during the growth of the credit derivatives market would benefit all market participants, even as no one participant had the ability to unilaterally solve the backlog

problem. If final rules prevent a recurrence of the backlog, as active participants in the SBS market intermediating the vast majority of SBS transactions, registered SBS Entities will benefit from reductions in market, credit, and settlement risks that accompany the reduced risk of a backlog recurrence.

### 3. Costs and Benefits to Non-Registered Market Participants

Final trade confirmation rules impose no regulatory requirements on non-registered market participants. However, we expect that market participants transacting with registered SBS Entities may benefit from timely acknowledgment of the terms of a transaction. In particular, to the extent that current market practices differ from the requirements under the final rules, non-registered market participants may find that timely acknowledgment of the terms will allow them to detect errors in the trade acknowledgment more quickly, and may also speed up resolution of disputes. Improved accuracy may allow these participants to better manage their market and cash flow risks, reducing the overall costs of hedging.

In addition, we expect that non-registered participants will also benefit from the reduced risk of a backlog recurrence. As described above, market, credit, and settlement risks that accompany a confirmations backlog are not limited to registered entities, but rather affect all market participants and could contribute to broader market instability. Therefore, we expect non-registered participants, who represent the great majority of transacting entities in the SBS market, to benefit from the reduced risk of a backlog recurrence.

However, we acknowledge that while these rules impose no regulatory requirements or direct costs on non-registered market participants, final trade confirmation rules may nevertheless impose indirect costs on these participants through higher transaction costs. While the Commission believes that market participants may already be broadly conforming to these rules for their CDS transactions, SBS Entities may incur costs in developing electronic confirmation systems for their non-CDS security-based swap activity. To the extent that market conditions allow it, SBS Entities may be able to pass some of these costs onto their counterparties through increased transaction costs.

In addition, final trade confirmation rules require SBS Entities to establish, maintain, and enforce written policies and procedures that are reasonably

designed to obtain prompt verification of the terms of a trade acknowledgment from their counterparties, including non-registered counterparties. While this requirement imposes no direct obligations on non-registered market participants, the Commission recognizes that the requirement to establish, maintain, and enforce policies and procedures on prompt trade verification may cause SBS Entities to impose trade verification conditions on their counterparties that differ from current market practices. As a result, non-registered market participants may incur costs if new trade verification conditions necessitate upgrades to or investments in electronic trading and confirmation systems.

Because SBS Entities' future trade verification policies and procedures are unknown, the Commission lacks precise information on how market conventions on trade verification may change after adoption of final trade confirmation rules, as well as information that would allow us to quantify any costs associated with such changes. However, the Commission believes that any such costs would be incurred primarily by entities transacting in equity swaps. As highlighted in the Baseline, according to the 2013 ISDA Operations Benchmarking Survey, only 30% of equity derivative volume in 2012 was confirmed electronically, which suggests that some market participants transacting in equity swaps may need to invest in technology necessary to comply with the final rule's electronic confirmation requirements.<sup>306</sup> On the other hand, the market for credit derivatives has already achieved nearly 100% electronic confirmation within one business day, suggesting that any such costs may be minimal for market participants transacting in credit derivatives that are security-based swaps.<sup>307</sup>

<sup>306</sup> As discussed above in the Baseline, the equity derivatives category in the ISDA survey may include equity derivatives that do not meet the definition of 'security-based swap,' such as equity forwards, equity futures, and equity options. The survey lacks more-refined data that would allow us to differentiate between equity swaps and non-SBS equity derivatives.

<sup>307</sup> For the purposes of the survey, ISDA defines electronic confirmation as, "The process by which derivative post-trade processes are automated. Confirmations are submitted to an electronic platform for matching, e.g., MarkitWire, DTCC, Swift." See 2013 ISDA Operations Benchmarking Survey, page 28. This definition does not correspond precisely to the Commission's final rule on electronic confirmations, which allows for confirmation through any electronic means, and is not limited to matching services or other electronic platforms. Therefore, the extent to which market participants may need to invest in technology depends on SBS Entities' trade verification policies and procedures, and whether the trade verification

<sup>304</sup> (\$4,022,920 ongoing cost for maintaining OMS) + (\$877,250 for maintaining policies and procedures) = \$4,900,170 for all respondents. (\$4,900,170/55 Respondents) = \$89,094 per SBS Entity.

<sup>305</sup> Under current voluntary reporting regime, market participants report transaction terms to the TIW. As part of the reporting regime, trades entered into the TIW are confirmed electronically through MarkitSERV, a joint venture between DTCC and Markit.

#### 4. Costs and Benefits of the Substituted Compliance Provisions

The Commission believes that the availability of substituted compliance for trade confirmation requirements would not substantially change the benefits intended by the final trade confirmation rules. We note that the Commission may grant positive substituted compliance determinations when it concludes that regulatory requirements in a particular foreign jurisdiction achieve comparable regulatory outcomes. Thus, we do not expect that the availability of substituted compliance will diminish the risk-mitigation benefits that stem from timely and accurate trade confirmations and a reduced likelihood of a recurrence in the backlog of unconfirmed trades.

To the extent that substituted compliance eliminates duplicative compliance costs, registered foreign security-based swap Entities entering into SBS transactions that are eligible for substituted compliance may incur lower overall costs associated with providing trade confirmations to their counterparties than they would otherwise incur without the option of substituted compliance available, either because a registered foreign security-based swap Entity may have implemented foreign regulatory requirements that are determined comparable by the Commission, or because counterparties to a security-based swap transaction eligible for substituted compliance do not need to duplicate compliance with two sets of comparable requirements.

Under final rules adopted by the Commission in 2014, a substituted compliance request may be made by either a foreign regulatory jurisdiction on behalf of its market participants, or by a registered market participant itself.<sup>308</sup> The decision to request substituted compliance is purely voluntary. To the extent such requests are made by market participants, such participants would request substituted compliance only if, in their own assessment, compliance with applicable requirements under a foreign regulatory system was less costly than compliance with both the foreign regulatory regime and the relevant Title VII requirement,

conditions they impose on counterparties are narrow (e.g., verification must be provided on an electronic platform) or broad (e.g., terms may be verified over email). In an analogous scenario, based on discussions with the CFTC, Commission staff is not aware that dealers in CFTC-regulated swap products are imposing costly trade verification conditions on their unregistered counterparties.

<sup>308</sup> Cross-Border Adopting Release, 79 FR 47277.

including Title VII trade confirmation requirements. Even after a substituted compliance determination is made, market participants would only choose substituted compliance for trade confirmations if the private benefits they expect to receive from participating in the U.S. market exceed the private costs they expect to bear—that is, if participation in the U.S. market is beneficial and substituted compliance for trade confirmations is the least-cost alternative. Where substituted compliance increases the number of dealers active in the U.S. security-based swap market, or prevents existing participants from leaving the U.S. market and preserves counterparty relationships, we expect the final rules to promote efficient hedging and sharing of risks, as described above.

#### 5. Costs and Benefits of the Clearing and Security-Based Swap Execution Facility and National Securities Exchange Exceptions

Under the final rule, a registered SBS Entity is not required to provide a trade acknowledgment or verification when the direct counterparty to the trade is a registered clearing agency.<sup>309</sup> As discussed above, the Commission believes that, as a matter of good business practice, registered clearing agencies may establish rules providing for appropriate documentation of SBS clearing transactions with all counterparties, including SBS Entities. Because central clearing of security-based swaps shifts the counterparty risk from individual counterparties to CCPs whose members collectively share the default risk of all members, it is in the economic interest of the clearing agency and its member firms to have confirmation policies in place to ensure that risks are properly documented. Indeed, as described above, ICE Clear Credit and ICE Clear Europe have rules in place designed to ensure that any SBS transactions submitted for clearing have been matched and confirmed prior to acceptance and processing by the registered clearing agency for clearing.

As a result, the Commission believes that requiring SBS Entities to also provide a trade acknowledgment to the clearing agency would be duplicative, without sufficient benefits to justify such a requirement. Similarly, the

<sup>309</sup> Our final rule differs from the CFTC's in this respect. The CFTC exempts transactions with a clearing agency from its confirmation requirements only if the clearing agency has rules requiring confirmation at the time the trade is accepted for clearing. While we expect that clearing agencies registered with the Commission will have such a requirement, we do not condition our exemption for clearing transactions on the existence of such requirements.

Commission is adopting a conditional exception from an SBS Entity's trade confirmation obligations for transactions that are submitted for clearing within one business day after execution of the transaction. For these transactions, an SBS Entity would not have to complete a trade confirmation with its counterparty as long as the transaction is submitted to a clearing agency within the prescribed time limit and the rules of the clearing agency provide for or require the confirmation of all terms of the security-based swap transaction prior to or at the same time that the security-based swap transaction is accepted for clearing. As with the direct clearing transactions, the Commission believes that as long as the transaction is submitted to a clearing agency within a specified time and the clearing agency has the appropriate rules in place, the clearing exception will not reduce the benefits of the final trade confirmation rules.

For these reasons, the Commission believes that requiring SBS Entities to provide trade confirmation for clearing transactions, as well as transactions submitted for clearing, would be duplicative, increasing compliance costs without corresponding increases in benefits. Allowing an exception should therefore conserve resources and reduce costs for market participants without decreasing the risk mitigation benefits that accompany timely and accurate confirmation of SBS transactions.

The Commission is also adopting a final rule that excepts SBS Entities from trade confirmation requirements for transactions executed on a registered security-based swap execution facility or national securities exchange, provided that the execution facility or national securities exchange has rules for promptly acknowledging and verifying the terms of transactions with market participants. As we noted above, trade confirmations serve to mitigate market, credit, and settlement risks that can occur when, due to, among other reasons, errors and miscommunications, counterparties do not agree on the terms of a trade. Such risks are inherent in bilateral negotiations, but the Commission believes they are less likely on transparent trading venues, where contract terms are standardized and readily available.

Furthermore, this exception is available only if the trade acknowledgment and verification provided by the execution facility or exchange is delivered in accordance with the requirements of the final rules—that is, by the end of the first business day following the day of execution—and provides all the terms of

the transaction, consistent with the obligations for SBS Entities. Thus, from the standpoint of counterparties to SBS Entities, there are no material differences between trade acknowledgments provided by SBS Entities and trade acknowledgments provided by execution facilities; the only difference is the entity that provides the acknowledgment and receives the verification (or dispute of terms).

Nevertheless, while SBS Entities are required to provide trade acknowledgments to their counterparties within one business day of execution, execution facilities and exchanges are only required to deliver the trade acknowledgment promptly. Therefore, under the final rule, there is the potential for trade confirmations provided by execution facilities and exchanges to be delayed relative to confirmations provided by SBS Entities. However, as discussed above, the Commission believes that risks associated with unconfirmed transactions are less likely for trades that take place on transparent trading venues, where contract terms are standardized and readily available to market participants. As a result, the cost of delayed transactions should be lower for SBS transactions executed on transparent venues relative to SBS transactions executed bilaterally.

#### 6. Exemption From Rule 10b-10

Included in the final rule is an exemption from Rule 10b-10 that applies when an SBS Entity is acting as principal for its own account in a security-based swap transaction. Because security-based swaps meet the statutory definition of a security, an SBS Entity that is also a broker or dealer could be required to comply with both Rule 10b-10 and Rule 15Fi-2 with respect to the same transaction. In the case of principal transactions, such a requirement would be duplicative, without corresponding benefits, since an SBS Entity that is also a broker-dealer would effectively be required to provide two sets of similar disclosures to the same counterparty. As a result, the included exemption should mitigate unnecessary burdens that would fall on SBS Entities that are also broker-dealers due the statutory extension of the definition of “security” to include security-based swaps.

#### D. Alternatives Considered

##### 1. Trade Acknowledgment Rules

The Commission has evaluated reasonable alternatives to the final trade acknowledgment requirements. In

particular, we have considered limiting third parties permitted to provide trade acknowledgments to registered clearing agencies only, requiring trade acknowledgments for electronic transactions to be provided within 30 minutes of execution, and requiring a trade acknowledgment to include an enumerated list of terms. In general, we do not believe that these alternatives would materially alter the primary benefits of the rules—that is, we expect that these alternatives would continue to reduce the likelihood of a recurrence in the confirmations backlog, along with the market, credit, settlement, and financial stability risks that would accompany a backlog. However, we believe these alternatives could increase compliance costs without corresponding increases in benefits. For example, we estimate that greater than half of potential SBS Entities would be dual-registered with the CFTC. To the extent that these alternatives differ from the CFTC’s trade confirmation rules, registered SBS Entities—who potentially use the same personnel to effect both swaps and security-based swaps—would have to comply with two sets of rules designed to achieve the same objective.

##### a. Approved Third Parties

As in the proposal, the Commission has considered limiting the set of third parties permitted to provide trade acknowledgments to registered clearing agencies only. Relative to the final rule, we expect that this alternative could increase compliance costs by reducing operational flexibility. In particular, for SBS transactions executed on a security-based swap execution facility or national securities exchange, we expect that the SBSEF, as part of an electronic transaction, will have the requisite information to satisfy the trade acknowledgment requirement on behalf of an SBS Entity. Furthermore, because the SBSEF will have electronic systems in place to execute transactions, it likely will be able to provide electronic trade acknowledgments at costs that are comparable to that of a clearing agency. For uncleared trades, limiting the set of approved parties to registered clearing agencies could therefore increase costs by requiring SBS Entities who choose to use third parties for their trade confirmations to include an additional intermediary for platform-executed transactions.

##### b. Time of Acknowledgment

The Commission proposed and considered adopting a final rule requiring trade acknowledgments within 15 minutes for trades executed

and processed electronically, and within 30 minutes for trades not executed electronically but processed electronically. While timelier acknowledgment has the potential to decrease risk management costs—by providing counterparties with confirmation of transaction terms more quickly, reducing the likelihood of errors in hedges—these benefits are not without cost. In particular, as noted by commenters, 30 minutes may not provide sufficient time for certain asset classes, or for transactions intermediated by investment advisers acting as agent for a client. In such transactions, the ultimate counterparty may not be known within 30 minutes; this could lead inaccurate acknowledgments disseminated only to satisfy regulatory requirements, with revised acknowledgments, duplications, or cancellations provided at a later time with the final terms of the trade.

##### c. Terms of the Transaction

Finally, the Commission proposed and considered adopting a final rule with an enumerated list of terms to be disseminated as part of the trade acknowledgment. The Commission believes this approach would be less effective in the sense that it fails to acknowledge that the terms of a transaction may differ across different classes of security-based swap and bespoke security-based swaps. In this sense, adopting this alternative could fail to reduce settlement risks if a term of a particular SBS is not on the enumerated list.

In addition, this alternative may increase compliance costs due to differences with the CFTC’s final approach. Unlike the Time of Acknowledgment requirement, where dual registrants complying with a potential 30-minute requirement for SBS would automatically be complying with the CFTC’s one-business-day requirement, an enumerated list of terms is not necessarily a subset of all terms, or vice versa. Therefore, market participants registered with both the SEC as SBS Entities and the CFTC as Swap Entities would be required to maintain separate trade acknowledgment systems for swaps and SBS, which likely would increase overall compliance costs relative to the final rule that is largely harmonized with the CFTC.

#### 2. Clearing Transactions

The Commission considered requiring SBS Entities to provide trade acknowledgments to registered clearing agencies when the clearing agency is a direct counterparty and also considered

requiring SBS Entities to provide trade acknowledgments to the counterparties for transactions subsequently submitted for clearing. While such requirements would benefit counterparties to SBS Entities, by ensuring that they receive trade acknowledgments within the specified time, the Commission believes this requirement would ultimately be duplicative. As described above, the rules, procedures, and processes of registered clearing agencies that provide central counterparty services for security-based swaps are generally designed to ensure that the terms of SBS transactions submitted for clearing have been matched and confirmed prior to or at the same time the transaction is accepted by the registered clearing agency for clearing. The Commission believes that, in circumstances where the clearing agency's rules, procedures or processes provide for the same outcome as those the final trade confirmations rule is designed to achieve, it is unnecessary to require SBS Entities to duplicate the trade confirmation. Furthermore, in circumstances where a clearing agency's rules, procedures or processes do not require trade confirmations, the exception for cleared transactions would not be available.

### 3. Certain Transactions on a Security-Based Swap Execution Facility or a National Securities Exchange

The Commission considered requiring SBS Entities to provide trade acknowledgments for all transactions executed on a trading platform, including transactions intended to be cleared. We note that, as a practical matter, SBS Entities would not be able to satisfy trade confirmation obligations with anonymous counterparties; mandating a trade confirmation requirement for transactions executed on a swap execution facility or national securities exchange would therefore preclude anonymous transactions. To the extent that there exists certain market participants who prefer to transact anonymously, such a requirement could potentially reduce liquidity and the overall supply of security-based swaps available for trade, as well as the set of counterparties available for hedging and sharing of risks.

As an alternative to requiring SBS Entities to provide trade acknowledgments for platform-executed trades, the Commission could limit the exception for platform-executed trades to cleared, anonymous transactions, retaining the trade confirmation requirement for all other transactions executed on an execution facility. Such

requirements could be potentially duplicative, without corresponding benefits. Under this alternative, the execution facility would be required to provide trade confirmations for anonymous transactions, and would therefore have the systems and infrastructure in place to provide confirmations for all transactions executed on the facility. If the execution facility chose to provide confirmations for all transactions as a matter of routine practice, there would be little benefit to requiring the SBS Entity to duplicate the confirmation, as long as the confirmation provided by the execution facility satisfied the time, form, and content requirements prescribed by Rule 15Fi-2.

#### *E. Comment and Response to Comment*

One commenter suggested that the Commission's estimated cost of \$66,650 per entity to develop an internal order and trade management system very seriously underestimates the cost.<sup>310</sup> As discussed above in Section VI.B.4, based on Commission staff discussions with this commenter, the Commission believes its cost estimates remain appropriate. In particular, because the rule the Commission is adopting is much more closely aligned with the CFTC Rule than the proposed rule was, we believe our original estimates do not underestimate the actual cost of the rule as adopted.

### **VIII. Regulatory Flexibility Act Certification**

The Regulatory Flexibility Act ("RFA")<sup>311</sup> requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Pursuant to Section 605(b) of the RFA,<sup>312</sup> the Commission certified in the Proposing Release and Cross-Border Proposing Release, respectively, that proposed Rule 15Fi-1 and proposed Rule 3a71-6 would not, if adopted, have a significant economic impact on a substantial number of "small entities."<sup>313</sup> The Commission received no comments on these certifications.

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (i) When used

<sup>310</sup> ISDA I at 8.

<sup>311</sup> 5 U.S.C. 601 *et seq.*

<sup>312</sup> 5 U.S.C. 605(b).

<sup>313</sup> Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term small entity for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Statement of Management on Internal Control, Exchange Act Release No. 18451 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982).

with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of \$5 million or less;<sup>314</sup> or (ii) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,<sup>315</sup> or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.<sup>316</sup> Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (i) For entities in credit intermediation and related activities,<sup>317</sup> entities with \$550 million or less in assets or, (ii) for non-depository credit intermediation and certain other activities,<sup>318</sup> \$38.5 million or less in annual receipts; (iii) for entities in financial investments and related activities,<sup>319</sup> entities with \$38.5 million or less in annual receipts; (iv) for insurance carriers and entities in related activities,<sup>320</sup> entities with \$38.5 million or less in annual receipts, or 1,500 employees for direct property and casualty insurance carriers; and (v) for funds, trusts, and other financial

<sup>314</sup> See 17 CFR 240.0-10(a).

<sup>315</sup> See 17 CFR 240.17a-5(d).

<sup>316</sup> See 17 CFR 240.0-10(c).

<sup>317</sup> Including commercial banks, savings institutions, credit unions, firms involved in other depository credit intermediation, credit card issuing, sales financing, consumer lending, real estate credit, and international trade financing. 13 CFR 121.201 at Subsector 522.

<sup>318</sup> Including firms involved in secondary market financing, all other non-depository credit intermediation, mortgage and nonmortgage loan brokers, financial transactions processing, reserve, and clearing house activities, and other activities related to credit intermediation. 13 CFR 121.201 at Subsector 522.

<sup>319</sup> Including firms involved in investment banking and securities dealing, securities brokerage, commodity contracts dealing, commodity contracts brokerage, securities and commodity exchanges, miscellaneous intermediation, portfolio management, providing investment advice, trust, fiduciary and custody activities, and miscellaneous financial investment activities. 13 CFR 121.201 at Subsector 523.

<sup>320</sup> Including direct life insurance carriers, direct health and medical insurance carriers, direct property and casualty insurance carriers, direct title insurance carriers, other direct insurance (except life, health and medical) carriers, reinsurance carriers, insurance agencies and brokerages, claims adjusting, third party administration of insurance and pension funds, and all other insurance related activities. 13 CFR 121.201 at Subsector 524.

vehicles,<sup>321</sup> entities with \$32.5 million or less in annual receipts.<sup>322</sup>

With respect to SBS Entities, based on feedback from market participants and our information about the security-based swap markets, the Commission continues to believe that (1) the types of entities that would engage in more than a *de minimis* amount of dealing activity involving security-based swaps—which generally would be large financial institutions—would not be “small entities” for purposes of the RFA; and (2) the types of entities that may have security-based swap positions above the level required to be “major security-based swap participants” would not be “small entities” for purposes of the RFA.<sup>323</sup>

Therefore, the Commission continues to believe that Rules 15Fi-1 and 15Fi-2 and the amendment to Rule 3a71-6 will not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

For the foregoing reasons, the Commission certifies that Rules 15Fi-1 and 15Fi-2 and the amendment to Rule 3a71-6, as adopted, would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

## IX. Statutory Basis and Text of Amendments

The Commission is amending Rule 3a71-6 pursuant to Sections 3(b), 15F, and 23(a) of the Exchange Act, as amended. Additionally, the Commission is adopting Rule 15Fi-1 and Rule 15Fi-2 pursuant to Section 15F of the Exchange Act, as amended.

### List of Subjects in 17 CFR Part 240

Major security-based swap participants, Reporting and recordkeeping requirements, Securities, Security-based swaps, Security-based swap dealers.

In accordance with the foregoing, the Securities and Exchange Commission is amending Title 17, chapter II of the Code of Federal Regulations as follows:

## PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The general authority citation for Part 240 continues to read as follows:

<sup>321</sup> Including pension funds, health and welfare funds, other insurance funds, open-end investment funds, trusts, estates, and agency accounts, real estate investment trusts and other financial vehicles. 13 CFR 121.201 at Subsector 525.

<sup>322</sup> See 13 CFR 121.201.

<sup>323</sup> See SBS Books and Records Proposing Release, *supra* note 128, 79 FR at 25296-97 and n.1441; Intermediary Definitions Adopting Release, *supra* note 3, 77 FR at 30743.

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78dd, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 *et seq.*, and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376 (2010), unless otherwise noted.

\* \* \* \* \*

■ 2. Section 240.3a71-6(d) is amended by adding paragraph (d)(3) to read as follows:

### § 240.3a71-6 Substituted compliance for security-based swap dealers and major security-based swap participants.

\* \* \* \* \*

(d) \* \* \*

(3) *Trade acknowledgment and verification.* The trade acknowledgment and verification requirements of section 15F(i) of the Act (15 U.S.C. 78o-10(i)) and § 240.15Fi-2; provided, however, that prior to making such a substituted compliance determination the Commission intends to consider whether the information that is required to be provided pursuant to the requirements of the foreign financial regulatory system, and the manner and timeframe by which that information must be provided, are comparable to those required pursuant to the applicable provisions arising under the Act and its rules and regulations.

\* \* \* \* \*

■ 3. Revise the undesignated center heading following § 240.15Cc1-1 to read as follows:

### REGISTRATION AND REGULATION OF SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS

■ 4. Add § 240.15Fi-1 and § 240.15Fi-2 to read as follows:

#### § 240.15Fi-1 Definitions.

For the purposes of § 240.15Fi-1 and § 240.15Fi-2:

(a) The term *business day* means any day other than a Saturday, Sunday, or legal holiday.

(b) The term *clearing agency* means a clearing agency as defined in section 3(a)(23) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(23)) that is registered pursuant to section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1) and provides central counterparty services for security-based swap transactions.

(c) The term *clearing transaction* means a security-based swap that has a clearing agency as a direct counterparty.

(d) The term *day of execution* means the calendar day of the counterparty to

the security-based swap transaction that ends the latest, provided that if a security-based swap transaction is

(1) Entered into after 4:00 p.m. in the place of a counterparty; or

(2) Entered into on a day that is not a business day in the place of a counterparty, then such security-based swap transaction shall be deemed to have been entered into by that counterparty on the immediately succeeding business day of that counterparty, and the day of execution shall be determined with reference to such business day.

(e) The term *execution* means the point at which the counterparties become irrevocably bound to a transaction under applicable law.

(f) The term *security-based swap execution facility* means a security-based swap execution facility as defined in section 3(a)(77) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(77)) that is registered pursuant to section 3D of the Securities Exchange Act of 1934 (15 U.S.C. 78c-4).

(g) The term *national securities exchange* means an exchange as defined in section 3(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(1)) that is registered pursuant to section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f).

(h) The term *trade acknowledgment* means a written or electronic record of a security-based swap transaction sent by one counterparty of the security-based swap transaction to the other.

(i) The term *verification* means the process by which a trade acknowledgment has been manually, electronically, or by some other legally equivalent means, signed by the receiving counterparty.

#### § 240.15Fi-2 Acknowledgment and verification of security-based swap transactions.

(a) *Trade acknowledgment requirement.* In any transaction in which a security-based swap dealer or major security-based swap participant purchases from or sells to any counterparty a security-based swap, a trade acknowledgment must be provided by:

(1) The security-based swap dealer, if the transaction is between a security-based swap dealer and a major security-based swap participant;

(2) The security-based swap dealer or major security-based swap participant, if only one counterparty in the transaction is a security-based swap dealer or major security-based swap participant; or

(3) The counterparty that the counterparties have agreed will provide

the trade acknowledgment in any transaction other than one described by paragraph (a)(1) or (a)(2) of this section.

(b) *Prescribed time.* Any trade acknowledgment required by paragraph (a) of this section must be provided promptly, but in any event by the end of the first business day following the day of execution.

(c) *Form and content of trade acknowledgment.* Any trade acknowledgment required by paragraph (a) of this section must be provided through electronic means that provide reasonable assurance of delivery and a record of transmittal, and must disclose all the terms of the security-based swap transaction.

(d) *Trade verification.* (1) A security-based swap dealer or major security-based swap participant must establish, maintain, and enforce written policies and procedures that are reasonably designed to obtain prompt verification of the terms of a trade acknowledgment provided pursuant to paragraph (a) of this section.

(2) A security-based swap dealer or major security-based swap participant must promptly verify the accuracy of, or dispute with its counterparty, the terms of a trade acknowledgment it receives pursuant to paragraph (a) of this section.

(e) *Exception for clearing transactions.* A security-based swap dealer or major security-based swap participant is excepted from the requirements of this section with respect to any clearing transaction.

(f) Exception for transactions executed on a security-based swap execution facility or national securities exchange or accepted for clearing by a clearing agency.

(1) A security-based swap dealer or major security-based swap participant is excepted from the requirements of this subsection with respect to any security-based swap transaction executed on a security-based swap execution facility or national securities exchange, provided that the rules, procedures or processes of the security-based swap execution facility or national securities exchange provide for the acknowledgment and verification of all terms of the security-based swap transaction no later than the time required by paragraphs (b) and (d)(2) of this section.

(2) A security-based swap dealer or major security-based swap participant is excepted from the requirements of this subsection with respect to any security-based swap transaction that is submitted for clearing to a clearing agency, provided that:

(i) The security-based swap transaction is submitted for clearing as soon as technologically practicable, but in any event no later than the time established for providing a trade acknowledgment under paragraph (b) of this section; and

(ii) The rules, procedures or processes of the clearing agency provide for the acknowledgment and verification of all terms of the security-based swap transaction prior to or at the same time

that the security-based swap transaction is accepted for clearing.

(3) If a security-based swap dealer or major security-based swap participant receives notice that a security-based swap transaction has not been acknowledged and verified pursuant to the rules, procedures or processes of a security-based swap execution facility or a national securities exchange, or accepted for clearing by a clearing agency, the security-based swap dealer or major security-based swap participant shall comply with the requirements of this section with respect to such security-based swap transaction as if such security-based swap transaction were executed at the time the security-based swap dealer or major security-based swap participant receives such notice.

(g) *Exemption from § 240.10b-10.* A security-based swap dealer or major security-based swap participant that is also a broker or dealer, is purchasing from or selling to any counterparty, and that complies with paragraph (a) or (d)(2) of this section with respect to the security-based swap transaction, is exempt from the requirements of § 240.10b-10 with respect to the security-based swap transaction.

By the Commission.

Dated: June 8, 2016.

**Robert W. Errett,**  
*Deputy Secretary.*

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