

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 240**

**Release No. 34-63727; File No. S7-03-11**

**RIN 3235-AK91**

**TRADE ACKNOWLEDGMENT AND VERIFICATION OF SECURITY-BASED SWAP TRANSACTIONS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed 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 proposing rule 15Fi-1 under the Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. § 78a *et seq.*, which would require 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.

**DATES:** Comments should be received on or before February 22, 2011.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission’s Internet comment form  
(<http://www.sec.gov/rules/proposed.shtml>);
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-03-11 on the subject line; or

- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-03-11. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Joseph Furey, Assistant Chief Counsel; Darren Vieira, Special Counsel; or Ignacio Sandoval, Attorney, at (202) 551-5550, Office of Chief Counsel, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

**SUPPLEMENTARY INFORMATION:** The Commission is proposing rule 15Fi-1 pursuant to Section 15F of the Exchange Act.<sup>1</sup>

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<sup>1</sup> 15 U.S.C. 78o-8.

## **I. Background**

Section 764 of the Dodd-Frank Act,<sup>2</sup> enacted on July 21, 2010, added Section 15F to the Exchange Act.<sup>3</sup> Among other things, Section 15F requires security-based swap (“SBS”) dealers and major SBS participants (collectively, “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 SBS Entities must “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 provides that the Commission must adopt rules governing documentation standards for SBS Entities. Proposed rule 15Fi-1 would prescribe standards related to timely and accurate confirmation and documentation of SBS, as further described below.

Market participants currently issue a “trade acknowledgment” (sometimes referred to by industry 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. If an SBS transaction is not reduced to writing, a court may have to supply contract terms upon which there was no previous agreement. For this reason, prudent practice requires that, after coming to an agreement on the terms of a transaction, the parties document the transaction in a complete and definitive written record so there is legal certainty about the terms of their agreement in case those terms are later disputed. Therefore, industry best practices incorporate a

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<sup>2</sup> Pub. L. 111-203, 124 Stat. 1376 (2010).

<sup>3</sup> 15 U.S.C. 78o-8.

process by which the parties verify that the trade acknowledgment accurately reflects the terms of their trade.<sup>4</sup> This process, through which one party 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 parties.<sup>5</sup> This confirmation includes any transaction-specific modifications to master agreements between the parties 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 party and verified by the other where that record has been manually, electronically, or by some other legally equivalent means, signed by the receiving counterparty.

In the past few years, market participants and regulators have paid particular attention to the timely confirmation of SBS transactions. The Government Accountability Office has found that, since 2002, the trading volume of SBS such as credit derivatives has expanded rapidly, causing stresses on the operational infrastructure of market participants, which in turn caused the participants’ back office systems to fail for a period of time to confirm the increased volume of trades.<sup>6</sup> The GAO viewed the lack of automation and the purported assignment of positions by transferring parties to

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<sup>4</sup> See Part II.D, below, for a discussion of verification.

<sup>5</sup> Confirmations may also be used by SBS Entities to make certain disclosures, or to disclaim certain obligations, to a counterparty. Required disclosures by an SBS Entity will be addressed separately in proposed “external business conduct” rules for SBS Entities.

<sup>6</sup> U.S. Government Accountability Office (“GAO”), Credit Derivatives: Confirmation Backlogs Increased Dealers’ Operational Risks, But Were Successfully Addressed After Joint Regulatory Action, GAO-07-716 (2007) at pages 3-4 (“GAO Confirmation Report”). As of September 2005, the accumulated backlog of unconfirmed over-the-counter credit derivatives trades was 150,000.

third parties without notice to their counterparties as the primary factors contributing to this backlog.<sup>7</sup> The GAO 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. Moreover, if purported transfers of SBS transactions are made without giving notice to the remaining parties and obtaining their consent, disputes may arise as to which parties are entitled to the benefits and subject to the burdens of the transaction. The GAO found that these circumstances created significant legal and operational risk for market participants.<sup>8</sup> These risks, as well as other operational issues associated with the over-the-counter derivatives market, have been the focus of reports and recommendations by the President’s Working Group,<sup>9</sup> and of ongoing efforts led by the Federal Reserve Bank of New York (“FRBNY”) to enhance operational capacity in the over-the-counter derivatives market and improve operational performance, by increasing automation, promoting timely confirmation of trades, and ending practices such as the purported unilateral transferring of SBS transactions.<sup>10</sup>

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<sup>7</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 pages 17-18.

<sup>8</sup> Id. at pages 12-15.

<sup>9</sup> See, e.g., Press Release, President’s Working Group on Financial Markets, Progress Summary on OTC Derivatives Operational Improvements (November 2008).

<sup>10</sup> See, e.g., FRBNY, Summary of OTC Derivatives Commitments (March 1, 2010).

To promote the efficient operation of the SBS market, and to facilitate market participants' management of their SBS-related risk, the Commission is proposing a confirmation process in rule 15Fi-1. The proposed rule will govern the delivery of SBS trade acknowledgments and the verification of those trade acknowledgments, as described more fully below. In developing this proposed rule, the Commission has consulted with other financial regulators, including the Commodity Futures Trading Commission and the Board of Governors of the Federal Reserve System.

The Commission understands that proposed rule 15Fi-1, as well as other proposals that the Commission may consider in the coming months to implement the Dodd-Frank Act, if adopted, could significantly affect — and be significantly affected by — the nature and scope of the security-based swaps market in a number of ways. For example, the Commission recognizes that if the measures it adopts are too onerous for existing participants or new entrants, they could hinder the further development of a market for SBS by unduly discouraging participation by SBS Entities. On the other hand, if the Commission adopts rules that are too permissive, they may not adequately protect investor interests or promote the purposes of the Exchange Act. We also are aware that the further development of the SBS market may require the Commission to revise its confirmation standards for SBS transactions. We urge commenters, as they review our proposal, to consider generally the role that regulation may play in fostering or limiting the development of the market for SBS (or the role that market developments may play in changing the nature and implications of regulation) and specifically to focus on this issue with respect to the proposed trade acknowledgment and verification rule for SBS Entities.

## II. Discussion of the Proposed Rule

Proposed Exchange Act rule 15Fi-1 would require SBS Entities to provide to their counterparties a trade acknowledgment, to provide prompt verification of the terms provided in a trade acknowledgment of transactions from other SBS Entities, and to establish, maintain, and enforce policies and procedures that are reasonably designed to obtain prompt verification of the terms provided in a trade acknowledgment. We are proposing to define several key terms in the rule to have the meaning that we believe is commonly attributed to those terms by industry participants. Thus, as discussed above, we propose 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>11</sup> As used in the proposed rule, 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>12</sup> Thus, a “confirmed” SBS transaction would mean a transaction in which the parties have produced a trade acknowledgment that is agreed to by both parties and that has been verified.<sup>13</sup>

Proposed rule 15Fi-1 would require certain SBS Entities that purchase or sell any SBS to provide an electronic trade acknowledgment to the applicable counterparty containing certain required information – discussed in Part II.C, below – within the prescribed timeframe. By requiring counterparties to provide trade acknowledgments of and to verify SBS transactions in a timely way, proposed rule 15Fi-1 is intended to promote the principles of Exchange Act Section 15F(i)(1).

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<sup>11</sup> See proposed Rule 15Fi-1(a)(10).

<sup>12</sup> See proposed Rule 15Fi-1(a)(13).

<sup>13</sup> See proposed Rule 15Fi-1(a)(4).

## **Request for Comment**

The Commission requests comment on all aspects of the proposed definitions of trade acknowledgment, verification and confirmation.

### **A. Trade Acknowledgment Requirement**

#### **1. Events Triggering the Trade Acknowledgment Obligation**

Proposed rule 15Fi-1(b) would require an SBS Entity that purchases or sells any security-based swap to provide a trade acknowledgment to its counterparty. The terms “purchase” and “sale” are defined in Section 3(a) of the Exchange Act.<sup>14</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>15</sup> Because the 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.

## **Request for Comment**

The Commission requests comment on all aspects of the proposal as to the events that would trigger an obligation to provide a trade acknowledgment.

1. Are there circumstances, other than purchases or sales of SBS, when SBS Entities should be required to provide SBS trade acknowledgments to their counterparties?

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<sup>14</sup> 15 U.S.C. 78c(a)

<sup>15</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).



2. What are the current market practices with respect to confirming SBS transactions?
3. How would current industry practices for confirming transactions be affected by the proposed rule?
4. How should policies and procedures to verify trade acknowledgments differ from current market practices, if at all?
5. What are the advantages or disadvantages of the proposed rule compared to current market practices? What additional costs would these differences entail?
6. Do participants currently have operations and/or departments in place to comply with the proposed requirements?
7. Do the benefits of promptly providing a trade acknowledgment justify the additional costs, and, if not, why not?
8. Many, if not most, types of securities transactions are complete upon settlement of the trade (usually shortly following execution), and the purchaser and seller have no continuing obligations to one another. In contrast, parties to SBS transactions have ongoing obligations to each other that could continue for years, depending on the term of the SBS transaction. The Commission has proposed to require parties to SBS transactions to report to an SBS data repository certain life-cycle events, some of which are included in the definition of purchase and sale and some of which, like corporate actions (e.g., mergers, dividends, stock splits, or bankruptcy), are

not.<sup>16</sup> The Commission understands that some parties may agree to notification upon life-cycle events, and that certain vendors track some of this information with regard to securities underlying certain credit default swaps. The Commission also notes that exchanges and other industry utilities currently publish similar information (e.g., ex-dividend dates, bankruptcies) with respect to the cash and derivatives markets. Should the Commission also require delivery of a trade acknowledgment and verification of any types of corporate actions? To what extent is it the industry custom currently to require notification to be provided about changes or life-cycle events in the security, loan, or narrow-based index that underlies an SBS? Should the proposed rule require trade acknowledgments for these changes or events?

9. Should the proposed rule require different procedures for terminations than for other purchases and sales? What are the current practices with respect to sending notices of termination? What information should be provided in an acknowledgment of a termination?

## **2. Who Provides the Trade Acknowledgment**

The Commission proposes using Section 13A(a)(3) of the Exchange Act as a model to determine which counterparty is responsible for providing the trade acknowledgment in the transaction. Section 13A(a)(1) provides that each SBS that is not accepted for clearing by a clearing agency or derivatives clearing organization must be

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<sup>16</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”).

reported to a swap data repository or to the Commission.<sup>17</sup> Section 13A(a)(3) specifies which party is obligated to make such reports – an SBS dealer, a major SBS participant, or a counterparty to the transaction – and it does not require both parties to report the same transaction.<sup>18</sup> Generally, Section 13A(a)(3) places the reporting burden on the party that is expected to transact in SBS more frequently. Similarly, the Commission proposes requiring only a single trade acknowledgment in any transaction, and requiring that, in a transaction to which an SBS Entity is a party, the party responsible for providing the trade acknowledgment would be determined in the same manner as the party responsible for reporting the transaction to an SBS data repository or to the Commission. Therefore, 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. In a transaction between an SBS dealer and a major SBS participant, the SBS dealer would be responsible for providing the trade acknowledgment. In a transaction where both parties are SBS dealers, or both parties are major SBS participants, the counterparties would be responsible for selecting which party must provide the trade acknowledgment.<sup>19</sup>

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<sup>17</sup> 15 U.S.C. 78m-1(a)(1).

<sup>18</sup> 15 U.S.C. 78m-1(a)(3).

<sup>19</sup> The Commission considered requiring all SBS Entities to provide SBS trade acknowledgments in each transaction to which they are a party, but preliminarily has determined not to propose this approach. Under that approach, in a situation where only one party is an SBS Entity, that party would provide the trade acknowledgment to its counterparty. In effect, this is similar to how broker-dealers are required to provide confirmations to their customers under Exchange Act rule 10b-10. However, the customers are under no obligation pursuant to rule 10b-10 to confirm their transactions with broker-dealers. In situations where both parties were SBS Entities, each party would cross-acknowledge the transaction by providing a duplicate trade acknowledgment to the other party. However, requiring cross-acknowledgment could be needlessly burdensome and may

Although the responsible counterparty would have the obligation to provide the trade acknowledgment, that counterparty could use a third-party to fulfill this obligation. The Commission expects that many transactions will be confirmed by “matching services” provided through a clearing agency.<sup>20</sup> We use matching service in this release to refer only to services through which two parties enter a new transaction.

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<sup>21</sup> of the transaction. The Commission believes that the use of clearing agencies’ matching services would promote the principles of Exchange Act Section 15F(i), and the Commission wishes to encourage SBS Entities to use these matching services. Accordingly, paragraph (b)(2) of the proposed rule would provide that an SBS Entity will have satisfied its requirement to provide a trade

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interfere with more efficient means of acknowledging transactions. Additionally, legal uncertainty could result if for some reason the trade acknowledgments did not match and neither party noticed or challenged the discrepancy.

<sup>20</sup> Under the proposed rule, the term “clearing agency” would mean a clearing agency registered pursuant to section 17A of the Exchange Act, 15 U.S.C. 78q-1. See proposed Rule 15Fi-1(a)(3). A clearing agency that captures trade information regarding a securities transaction and performs an independent comparison of that information which results in the issuance of legally binding matched terms to the transaction is providing matching services. See, also, Exchange Act Release No. 39829 (April 6, 1998), 63 FR 17943 (April 13, 1998) (File No. S7-10-98) (“A vendor that provides a matching service will actively compare trade and allocation information and will issue the affirmed confirmation that will be used in settling the transaction.”).

<sup>21</sup> “Confirmation” means a trade acknowledgment that has been subject to verification. See proposed Rule 15Fi-1(a)(4).

acknowledgment if a clearing agency, through its facilities, produces a confirmation of the SBS transaction.<sup>22</sup>

A clearing agency may also serve as a central clearing counterparty (“CCP”) in SBS transactions. In a CCP arrangement, if the original counterparties to a bilateral SBS transaction are clearing members, they novate their bilateral trade to the clearing agency (acting as a CCP). In such a novation to a CCP, each counterparty terminates its contract with the other and enters into a new contract on identical terms with the CCP. In this way, the CCP becomes buyer to one counterparty and seller to the other.<sup>23</sup> The novation would constitute a purchase from or a sale to the clearing agency. While the purchase or sale would require a trade acknowledgment under paragraph (b)(1) of the proposed rule, paragraph (b)(2) of the proposed rule would permit the CCP to satisfy the SBS Entity’s obligation to provide a trade acknowledgment to its counterparty, both for the initial bilateral transaction between an SBS Entity and its counterparty that are clearing members, and for the subsequent purchases or sales that result from the novation to the CCP.

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<sup>22</sup> In the course of clearing and settling SBS transactions, clearing agencies would need much or all of the information that is required on a trade acknowledgment, and therefore, the clearing agency would have in place systems to receive and process the information on a trade acknowledgment. The Commission notes that clearing agencies must: register with the Commission and submit their rules for review and approval by the Commission; meet minimum standards of care; have the capacity to enforce their rules and discipline their participants; and have chief compliance officers to oversee compliance with their statutory and regulatory obligations. The Commission believes that clearing agencies are thus equipped to manage the operations necessary to provide trade acknowledgments in the course of their work clearing and settling SBS transactions.

<sup>23</sup> See Exchange Act Release No. 59527 (Mar. 6, 2009).

## **Request for Comment**

The Commission solicits comment on all aspects of the allocation of responsibility between the parties for providing the trade acknowledgment.

10. Does the proposed rule appropriately allocate the responsibility to provide a trade acknowledgment?
11. Would permitting the parties to agree which party would provide a trade acknowledgment in all transactions, instead of only in transactions between two SBS dealers or two major SBS participants, be preferable?
12. Should the rule require each SBS Entity that is a party to an SBS transaction to provide a trade acknowledgment to its counterparty?
13. Should the rule allow persons other than clearing agencies, such as SBS execution facilities, to provide trade acknowledgments on behalf of SBS Entities?
14. Does the description of the use of matching services, above, accurately describe current market practice, including market practice in such forums as the inter-dealer market? If not, what current practices are not encompassed by the description?
15. Should clearing agencies 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? If so, under what conditions?

## **B. Time to Provide a Trade Acknowledgment**

The Commission believes that confirming SBS transactions shortly after execution should help to promote the stability of the SBS market by preventing documentation backlogs from creating uncertainty over SBS Entities' exposure to SBS.<sup>24</sup> There will be a lag between the time when an SBS is executed (i.e., the point at which both parties become irrevocably bound to a transaction under applicable law),<sup>25</sup> and when the transaction is confirmed (i.e., when a trade acknowledgment of the transaction is provided and verified). Requiring prompt provision of trade acknowledgments of electronically executed or processed SBS transactions should help SBS Entities to submit timely and accurate reports with respect to those transactions to SBS data repositories. However, the Commission believes that the goal of promptly providing trade acknowledgments must be tempered by the difficulty of achieving that goal, particularly for customized agreements that are not executed or processed<sup>26</sup> electronically.

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<sup>24</sup> The term "execution" would mean the point at which the parties become irrevocably bound to a transaction under applicable law. See proposed Rule 15Fi-1(a)(6).

<sup>25</sup> In the SBS context, an oral agreement over the telephone will create an enforceable contract, and the time of execution will be when the parties to the telephone call agree to the material terms.

<sup>26</sup> The term "processed electronically," with respect to an SBS transaction, would mean entered into a security-based swap dealer or major security-based swap participant's computerized processing systems after execution to facilitate clearance and settlement. See proposed Rule 15FI-1(a)(9). A clearing agency may process electronically its members' SBS transactions, as discussed further below.

Promptly providing a trade acknowledgment would assure that the parties know the terms of their executed agreement.<sup>27</sup> Accordingly, the Commission proposes that the maximum times for providing a trade acknowledgment of SBS transactions would vary depending upon whether transactions are electronically executed or electronically processed, but would not exceed 24 hours following execution. The Commission preliminarily believes that the prescribed times should be sufficient for SBS Entities to provide trade acknowledgments without permitting unnecessary delay. Specifically, proposed rule 15Fi-1(c)(1) would require 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 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. However, the Commission 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

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<sup>27</sup> Promptly acknowledging a transaction would also enable parties to comply with the required time within which data must be reported to an SBS data repository. See SBSR Proposing Release, note 16 supra.



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>28</sup> The Commission also understands that an SBS Entity's ability to process a transaction electronically may be limited by its counterparty's abilities. For example, an SBS Entity may have the ability to clear 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.

Thus, proposed rule 15Fi-1(c)(2) would require an SBS Entity to process electronically an SBS transaction if the SBS Entity 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 preliminarily believes 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.

### **Request for Comment**

The Commission solicits comment on all aspects of the proposed time to provide a trade acknowledgment, and the requirement for SBS Entities to process electronically all transactions for which they have the ability.

16. What is the current industry practice with respect to the time necessary to confirm trades, and does the operational infrastructure of SBS Entities makes

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<sup>28</sup> Transactions in non-standardized SBS that are individually negotiated and contain unique terms, or transactions effected telephonically and processed manually might fall into this category.

providing a trade acknowledgment within 24 hours of execution for manual trades feasible?

17. Should the proposed rule require an SBS Entity to provide a trade acknowledgment more quickly, particularly for transactions that are executed or processed electronically?
18. Would the proposed rule provide sufficient time for SBS Entities to provide trade acknowledgments to their counterparties?
19. Is there currently a backlog in confirming trades, and if so, would the proposed rule encourage confirming trades and reduce the backlog? Are there other procedures that would reduce any backlog of unconfirmed trades?
20. Are there circumstances in which certain terms included on a trade acknowledgment would not be agreed by the parties within 24 hours of execution? If so, please explain why parties may not be able to agree on such terms within 24 hours of the execution of the SBS transaction. How should an inability to obtain agreement on such contract terms within 24 hours of execution, when it happens, be handled?
21. How should the proposed rule address terms required to be on the trade acknowledgment that are not known on the date of execution?
22. How should the proposed rule address transactions between an SBS Entity and a fund manager or other agent, where the allocation of the trade to the fund manager's or agent's accounts is not determined by the fund manager or agent until sometime after execution? Should a delay in providing a trade

acknowledgment be permitted under these circumstances? If so, how long a delay should be permitted?

23. Should the proposed rule require SBS Entities that have the ability to process transactions electronically do so in all situations? Are there circumstances when an SBS Entity would have the ability to process a transaction electronically but should not be required to do so?

24. How often do trade acknowledgments contain inaccurate information and what are the most common errors? What procedures are currently in place to correct those errors?

### **C. Form and Content of Trade Acknowledgments**

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

The Commission anticipates that clearing agencies may be instrumental in delivering trade acknowledgments and verifying SBS transactions for their members, but that the roles played by individual clearing agencies may vary. For example, as discussed in Part II.A above, clearing agencies may provide matching services in which they perform independent comparisons of each security-based swap transaction participant's trade data regarding the terms of settlement of the transaction that result in the issuance

of legally binding matched terms to the transactions. Paragraph (b)(2) of the proposed rule would permit clearing agencies to provide trade acknowledgments on behalf of SBS Entities; however, SBS Entities would not be limited to using clearing agencies to provide trade acknowledgments electronically. SBS Entities may also 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). SBS Entities may also continue to rely on facsimile transmission or email to provide trade acknowledgments. The Commission understands these means of providing trade acknowledgments may be particularly necessary 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.

Providing trade acknowledgments exclusively by mail or overnight courier would not satisfy the requirements of the proposed rule. These delayed means of communication do not appear to promote the principles of Exchange Act Section 15F(i). Moreover, as discussed in Part II.E below, an SBS Entity must establish, maintain, and enforce policies and procedures to obtain prompt verification of the terms included in each trade acknowledgment it provides. This requirement does not appear compatible with processes to provide trade acknowledgments that rely on delayed means of communication.

Paragraph (d) of proposed rule 15Fi-1 would require trade acknowledgments to contain a minimum of 22 items of information, all but one of which is identical to the items that SBS Entities would be required to report to an SBS data repository pursuant to

the rules the Commission has separately proposed in Regulation SBSR.<sup>29</sup> We proposed to require the information in Regulation SBSR, in part, to facilitate regulatory oversight and monitoring of the SBS market by providing comprehensive information regarding SBS transactions and trading activity.<sup>30</sup> The Commission believes that counterparties to an SBS transaction would benefit from receiving a trade acknowledgment that is similarly comprehensive. In addition, by requiring essentially the same information to be included on a trade acknowledgment as is reported to an SBS data repository, the proposed rule should allow SBS Entities to use systems and databases designed to comply with Regulation SBSR to also comply with rule 15Fi-1 under the Exchange Act, which would reduce the burden of complying with proposed rule 15Fi-1.

The specific items that SBS Entities would provide in a trade acknowledgment under the proposed rule include: (1) the asset class<sup>31</sup> of the security-based swap and, if the security-based swap is an equity derivative, whether it is a total return swap or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the security-based swap is based; (2) information that identifies the security-based swap instrument and the specific asset(s) or issuer of a security on which the security-based swap is based; (3) the notional amount(s), and the currenc(ies) in which the notional amount(s) is expressed; (4) the date and time, to the second, of execution, expressed using Coordinated Universal Time (UTC); (5) the

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<sup>29</sup> See SBSR Proposing Release, note 16 supra.

<sup>30</sup> Id.

<sup>31</sup> The term “asset class” means those security-based swaps in a particular broad category, including, but not limited to, credit derivatives, equity derivatives, and loan-based derivatives. See proposed Rule 15Fi-1(a)(1).

effective date; (6) the scheduled termination date; (7) the price;<sup>32</sup> (8) the terms of any fixed or floating rate payments, and the frequency of any payments; (9) whether the security-based swap will be cleared by a clearing agency; (10) if both counterparties to a security-based swap are security-based swap dealers, an indication to that effect; (11) if the transaction involved an existing security-based swap, an indication that the transaction did not involve an opportunity to negotiate a material term of the contract, other than the counterparty; (12) if the security-based swap is customized to the extent that the information provided in items (1) through (11) does not provide all of the material information necessary to identify such customized security-based swap or does not contain the data elements necessary to calculate the price, an indication to that effect; (13) the participant ID of each counterparty; (14) as applicable, the broker ID, desk ID, and trader ID of the reporting party;<sup>33</sup> (15) the amount(s) and currenc(ies) of any up-front

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<sup>32</sup> The term “price” means the price of a security-based swap transaction, expressed in terms of the commercial conventions used in that asset class. See proposed Rule 15Fi-1(a)(8).

<sup>33</sup> Proposed Rule 15Fi-1(a) includes definitions for “unique identification code,” “broker ID,” “desk ID,” “participant ID,” and “trader ID.” Proposed Rule 15Fi-1(a)(12) defines “unique identification code” or “UIC” as the unique identification code assigned to a person, unit of a person, or product by or on behalf of an internationally recognized standards-setting body that imposes fees and usage restrictions that are fair and reasonable and not unreasonably discriminatory. 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. “Broker ID” is a UIC assigned to a person acting as a broker for a participant. Proposed Rule 15Fi-1(a)(2). “Desk ID” is a UIC assigned to the trading desk of a participant or of a broker of a participant. Proposed Rule 15Fi-1(a)(5). “Participant ID” is a UIC assigned to a participant. Proposed Rule 15Fi-1(a)(7). “Trader ID” is a UIC assigned to a natural person who executes security-based swaps. Proposed Rule 15Fi-1(a)(11). The definitions of UIC, broker ID, desk ID, participant ID, and trader ID are identical

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 (including the title of any document governing the satisfaction of margin obligations), 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 security-based swap will be cleared, the name of the clearing agency; (19) if the security-based swap is not cleared, whether the exception in Section 3C(g) of the Exchange Act was invoked;<sup>34</sup> (20) if the security-based swap 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 the settlement value; (21) the venue where the security-based swap was executed; and (22) if the transaction is to be cleared, any additional information that is required for the transaction to be cleared by a clearing agency.

The first 21 items are identical to the items that would be reported to an SBS data repository under proposed Regulation SBSR. In addition, if a transaction is to be cleared, proposed rule 15Fi-1(d)(22) would require SBS Entities to include on a trade acknowledgment any additional information that a clearing agency requires to clear the transaction. The Commission has oversight authority over clearing agencies, including

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to the definitions of the same terms the Commission has proposed in Regulation SBSR, and parties would use the same IDs for purposes of both rules. See SBSR Proposing Release, note 16 supra.

<sup>34</sup> Section 3C(g) of the Exchange Act provides certain exceptions from the general requirement of Section 3C(a)(1) of the Exchange Act that an SBS be submitted to a registered clearing agency or a clearing agency that is exempt from registration.

the ability to approve or disapprove all proposed rules and rule changes.<sup>35</sup> These proposed rules and rule changes are also published for public notice and comment. The Commission preliminarily believes that additional information that is significant to a clearing agency would also be significant to a counterparty, and thus should be included in the trade acknowledgment. An SBS Entity that is a clearing agency participant would be required to comply with (and therefore to know) the clearing agency's requirements because it is obligated to comply with the clearing agency's rules. If a clearing agency participant acting on behalf of an SBS Entity submits a transaction to a clearing agency, the participant would have to obtain the necessary information from the SBS Entity.

### **Request for Comment**

The Commission requests comment on all aspects of the proposal as to the form and content of the trade acknowledgment.

25. Is it feasible to require trade acknowledgments to be provided electronically?
26. Would the requirement for electronic trade acknowledgment unduly restrict the types of SBS transactions that SBS Entities may enter into or the persons that may be their counterparties?
27. Would permitting non-electronic means of providing trade acknowledgments further the Commission's objective to promote the timely and accurate confirmation, processing, netting, documentation, and valuation of all SBS?
28. What systems are used to provide confirmations today?
29. Should the proposed rule require SBS Entities to use other systems, such as electronic messaging systems that rely on machine readable structured data

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<sup>35</sup> See Exchange Act Section 19(b). Section 3(a)(26) of the Exchange Act defines "self-regulatory organization" to include a registered clearing agency.



(and therefore lend themselves to automated trade processing) or some other process, to provide trade acknowledgments? If so, please describe those systems.

30. Should we consider any enhancements to current market practices?
31. Would permitting trade acknowledgments to be provided by facsimile or email create problems or raise issues, and would the benefits of permitting acknowledgments to be provided by facsimile or email outweigh those problems or issues?
32. Would the requirement for trade acknowledgments to be provided through electronic means that provide reasonable assurance of delivery and a record of transmittal create difficulties for participants, for example, because some counterparties are unable to receive trade acknowledgments electronically, or because electronic trade acknowledgment is not feasible for transactions in certain asset classes?
33. Can the Commission's objective to promote the timely provision of trade acknowledgments be achieved if SBS Entities provide trade acknowledgments by non-electronic means, such as mail or overnight courier, and if so, how?
34. Should the proposed rule allow clearing agencies to use methods other than confirmation by matching or comparison to provide trade acknowledgments on behalf of SBS Entities?
35. Is there additional information that the proposed rule should require to be included on a trade acknowledgment?
36. Does the proposed rule require any information that is unnecessary?

37. The Commission has proposed that the trade acknowledgment contain a minimum of 22 items of information. In light of the purpose of the rule, should the Commission simply require instead that the trade acknowledgment must evidence the entire agreement of the parties? For example, the Commission could require a trade acknowledgment to include: (a) “all of the terms an SBS transaction”; (b) “all of the material terms of an SBS transaction”; (c) “all terms that the parties have agreed to at the time of execution”; (d) “all terms that are necessary for the parties to have a complete and definitive agreement”; or (e) “all the terms necessary to fully and completely describe the transaction.” Which of these alternatives is best, and why? Would it be clear how to comply with any or all of these possible alternatives? If not, why not? Would certain terms used in these alternative requirements require further definition, such as “complete and definitive,” or “fully and completely”? If so, what terms would require further definition, and how should they be defined? Would the alternative requirements encompass transaction terms that would otherwise not be included on a trade acknowledgment as required by the proposed rule and the enumerated items specified therein? If so, what additional transaction terms would be required? What would be the costs and benefits or disadvantages of such a principles-based requirement?
38. Please propose any alternative standards to those described in question 38 the Commission should consider, discuss what additional information would be

required under your alternatives, and the costs and benefits and the advantages and disadvantages of your proposed standards.

39. Should the Commission require markup/markdown disclosure or expected profitability/loss on a trade acknowledgment? If so, why, and if not, why not? How should SBS Entities calculate markup/markdown or expected profitability/loss? What would be the best evidence of the prevailing market price for a SBS transaction from which a markup or markdown could be calculated? Should the prevailing market price be based on a dealer's contemporaneous cost, its cost to hedge the transaction, or a dealer's sale to another SBS dealer or major SBS participant? Should there be any distinction between inter-dealer transactions and transactions between a dealer and a non-dealer? Are SBS dealers and/or major SBS participants acting as market makers?
40. The Commission understands that some SBS agreements may receive credit support from a guarantor or other credit support provider who agrees to satisfy a party's payment or margin obligations in the event of default. Should the trade acknowledgment include the legal name of or other information about the guarantor or credit support provider?
41. How does price differ, if at all, from market value?
42. Should the Commission require that a trade acknowledgment include in all cases the material information necessary to identify the SBS or the data elements necessary to calculate its price (rather than the proposal in paragraph (d)(12))?

43. Should the Commission require that a trade acknowledgment include in all cases the material information necessary to determine required upfront payments and any future cash flows (rather the proposal in paragraph (d)(12))?
44. Do parties typically provide the material information necessary to identify the SBS or the data elements necessary to calculate its price in a trade acknowledgment or confirmation? Are there any SBS transactions, such as highly customized SBS transactions, for which it would be difficult to provide this information? If so, please describe these transactions and the information that parties would be challenged to provide.
45. Section 3C(g)(1) of the Exchange Act provides an exception for certain counterparties from the mandatory clearing requirement in Exchange Act Section 3C(a)(1). In order to qualify for the exception, counterparties would need to comply with the Commission's rules and regulations, which may require that counterparties provide additional information to the Commission, such as how a counterparty invoking the clearing exception generally expects to meet its financial obligations associated with an SBS or the title of any agreements in place between the SBS Entity and the counterparty that would support such counterparty's financial obligations. Should the trade acknowledgment include such additional information that a counterparty may need to provide to the Commission? Should the trade acknowledgment include such additional information that a counterparty may need to provide to

the Commission to support that it is not a financial entity and is using the SBS to hedge or mitigate commercial risk?

46. The Commission also considered proposing a requirement that parties use master confirmation agreements for complex products when such agreements are in widespread use.<sup>36</sup> If the parties have entered into a master confirmation agreement, the transaction-specific confirmations may be less detailed because the confirmation would not repeat the standard terms included in the master confirmation agreement. The Commission believes that the use of master confirmation agreements reduces transaction costs, improves liquidity, and speeds back-office processing in the markets in which they are adopted, and therefore encourages their use. However, the Commission believes that it would be difficult for SBS Entities to determine whether a master confirmation agreement is “in widespread use” and therefore required to be used. The Commission solicits comment on whether to require the use of master confirmation agreements in markets in which they are widespread, and how the Commission and SBS Entities could determine whether master confirmation agreements are in widespread use.

#### **D. Trade Verification**

As part of the trade verification process, paragraph (e)(1) of proposed rule 15Fi-1 would require an SBS Entity to establish, maintain, and enforce reasonable written

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<sup>36</sup> Master confirmation agreements are agreements that incorporate by reference standardized agreements (such as the 1992 or 2002 ISDA Master Agreement) that allow parties to agree on most standard terms to be incorporated by reference into a complex trade and then execute individual transactions by agreeing on a small subset of economic terms.

policies and procedures to obtain the prompt verification of trade acknowledgments. The Commission preliminarily believes this requirement will induce SBS Entities to minimize the number of unverified trade acknowledgments, and thereby reduce the operational risk and uncertainty associated with unverified SBS transactions.

Verifying a transaction would require the SBS Entity responsible for providing the trade acknowledgment to obtain manually, electronically, or by some other legally equivalent means, the signature of its counterparty on the trade acknowledgment.<sup>37</sup> 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 party. 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 fax or electronically, where the first party 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 is designed to minimize the operational risk and uncertainty associated with SBS transactions for which trade acknowledgments have not been verified.

Pursuant to paragraph (e)(2) of the rule, cleared transactions would be verified in accordance with the process prescribed by the registered clearing agency through which the transaction will be cleared. The Commission expects that clearing agencies will adopt rules to obtain the signature of a counterparty on a trade acknowledgment as part of

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<sup>37</sup> See Proposed Rule 15Fi-1(a)(13).

their verification procedures. In electronically processed transactions, the clearing agency could obtain counterparties' signatures electronically or by other means. As noted above, the Commission has authority over registered clearing agencies, including the authority to review and approve or disapprove all proposed rules and rule changes.<sup>38</sup> The Commission would, therefore, be able to review any proposed rules and rule changes concerning verification of trade acknowledgments to determine whether the rules or rule changes are consistent with the purposes of proposed rule 15Fi-1.

For SBS transactions that are not subject to clearing, paragraph (e)(1) of the proposed rule would require 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.<sup>39</sup>

Paragraph (e)(2) of the proposed rule would provide that, in any SBS transaction to be cleared through a clearing agency, an SBS Entity's compliance with the verification process prescribed by the clearing agency satisfies the verification requirements of subparagraph (e)(1) with respect to the transaction. Therefore, an SBS

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<sup>38</sup> See Exchange Act Sec. 19(b).

<sup>39</sup> As described in Part A.2. above, 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.

Entity would not need to separately verify a transaction with another SBS Entity cleared through a clearing agency. Additionally, an SBS Entity would not be required to have separate written policies and procedures that are reasonably designed to obtain prompt verification of the terms of a trade acknowledgment if the SBS Entity enters a cleared transaction with a non-SBS Entity, and the SBS Entity complies with the clearing agency's verification process.

Paragraph (e)(3) of the proposed rule would require 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 is intended to reduce the incidence of unverified SBS transactions, thereby reducing the operational risk for SBS Entities.

### **Request for Comment**

The Commission solicits comment on all aspects of the proposed requirement that SBS Entities verify trade acknowledgments they receive, and establish, maintain, and enforce written policies and procedures to obtain the prompt verification of the terms of executed SBS transactions.

47. Should the proposed rule set time limits within which trade acknowledgments must be verified by SBS Entities? For example, should the proposed rule require SBS Entities to verify or dispute a trade acknowledgment within 24 or 48 hours of provision of the trade acknowledgment? Should SBS Entities be required to verify or dispute a trade acknowledgment more quickly for SBS transactions that are executed electronically or processed electronically than for other transactions?



48. What additional steps could the Commission take to promote verification of SBS transactions?
49. Should the Commission give more guidance in the types of policies and procedures it expects SBS Entities to adopt that would be “reasonably designed to obtain prompt verification of the terms of a trade acknowledgment”?
50. Are there other ways in which SBS participants currently evidence their agreement to an SBS transaction besides manual or electronic signature of a trade acknowledgment that we should consider?
51. The proposed rule requires that parties obtain “verification” of the trade acknowledgment, which would be defined to mean manual or electronic signature of the trade acknowledgment by the receiving party. Is this definition sufficient? Does this definition differ from current market practice, and if so, how?
52. Are there other processes currently in place that would not fit within this definition of “verification” that we should consider?
53. Although the Commission believes that matching services are an effective way to verify SBS transactions, and increase the efficiency of the SBS settlement process, the Commission has not proposed requiring SBS Entities to submit their trades to a matching service. The Commission is concerned that the variety of SBS transactions may make it unlikely that matching services would be able to verify all transactions, and the Commission questions whether all SBS Entities’ counterparties would be members or

participants (or eligible to be members or participants) in a matching service. Therefore, a requirement to submit all trades to a matching service could limit both the types of transactions and the counterparties in the SBS market. We request comment on the mandatory use of matching services. Would a requirement to use matching services limit the types of SBS transactions or counterparties in the market? How could the Commission mitigate those effects?

**E. Exemption from Rule 10b-10**

Proposed paragraph (f) of rule 15Fi-1 would provide an exemption from the requirements of rule 10b-10 under the Exchange Act for SBS Entities that confirm their SBS transactions in compliance with proposed rule 15Fi-1.<sup>40</sup> Rule 10b-10 generally requires that broker-dealers effecting securities transactions on behalf of customers, provide to their customers, at or before completion of the securities transaction, a written notification containing certain basic transaction terms.<sup>41</sup>

The Dodd-Frank Act amended the Exchange Act definition of “security” to include any “security-based swap.”<sup>42</sup> Consequently, SBS, as securities, are fully subject to the federal securities laws and regulations, including, rule 10b-10.<sup>43</sup> The Commission

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<sup>40</sup> 17 CFR 240.10b-10.

<sup>41</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>42</sup> Dodd-Frank Act Sec. 761(a)(2) (codified at Exchange Act Section 3(a)(10)).

<sup>43</sup> The Commission will discuss further the implications of defining “security” to include security-based swaps on the requirement for brokers and dealers to register with its proposed rules for SBS Entity registration.

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 would be required to comply with both rule 10b-10 and proposed rule 15Fi-1. This could be duplicative and overly burdensome.

The proposed exemption in paragraph (f) would apply solely to transactions in SBS in which an SBS Entity is also a broker or a dealer, and would not apply 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 SBS with customers.

As noted in Part A.1 above, because the proposed rule would apply 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 proposed exemption in paragraph (f) would also apply solely to principal transactions. The Commission recognizes that some SBS Entities may also engage in SBS brokerage or agency transactions.<sup>44</sup> 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>45</sup>

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<sup>44</sup> An SBS Entity’s agency activities would be done pursuant to its broker-dealer registration under Section 15(b) of the Exchange Act. 15 U.S.C. 78o(b).

<sup>45</sup> This would include, at a minimum, disclosure of: the date of the transaction; the identity, price and number of units (or the principal amount) bought or sold, and the time of the transaction or the fact that it will be furnished upon written request (17 CFR 240.10b-10(a)(1)); that they are acting in an agent capacity (17 CFR 240.10b-10(a)(2)); and, under specified circumstances, the amount of remuneration to be received by the broker from the customer, and whether the broker is receiving any other remuneration in connection with the transaction (17 CFR 240.10b-10(a)(2)(i)(B) and (D)).

## **Request for Comment**

The Commission solicits comment on all aspects of the proposed exemption from rule 10b-10 for SBS Entities that provide a trade acknowledgment pursuant to proposed rule 15Fi-1(f).

54. Is the proposed exemption from rule 10b-10 necessary or appropriate?

55. Is additional interpretive guidance regarding rule 10b-10 necessary?

## **III. Implementation Timeframes**

The Commission proposes that the rule be effective 60 days after publication of the final rule in the Federal Register.

### **Request for Comment**

The Commission solicits comment on all aspects of the implementation time frame for proposed rule 15Fi-1.

56. Would the proposed time frame provide sufficient time for SBS Entities to comply with the rule?

57. Should the implementation time be coordinated with the implementation timeframes for proposed Regulation SBSR?

## **IV. Paperwork Reduction Act**

Certain provisions of the proposed rule would result in “collection of information requirements” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).<sup>46</sup> The Commission is therefore submitting proposed rule 15Fi-1 to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. Compliance with the collection of information requirements would be

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<sup>46</sup> 44 U.S.C. 3501 et seq.

mandatory. 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.

#### **A. 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>47</sup> Section 15F(i)(2) of the Exchange Act further provides that the Commission must adopt rules governing documentation standards for SBS Entities. Accordingly, proposed rule 15Fi-1 would adopt documentation standards for the timely and accurate acknowledgment and verification of SBS transactions by SBS Entities. The proposed rule contains six paragraphs: (a) definitions of relevant terms; (b) the trade acknowledgment obligations of specific SBS Entities; (c) the prescribed time frames under which a trade acknowledgment must be sent; (d) the form and content requirements of the trade acknowledgment; (e) an SBS Entities’ verification obligations; and (f) a limited exemption for brokers from the requirements of Exchange Act Rule 10b-10.<sup>48</sup>

Under paragraph (b)(1) of proposed rule 15Fi-1, sending an SBS trade acknowledgment would be 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 any agreements between the counterparties that delineate the trade acknowledgment responsibility. Paragraph (b)(2) of the proposed rule however, would provide that SBS Entities will satisfy this requirement to the extent

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<sup>47</sup> 15 U.S.C. 78o-8.

<sup>48</sup> 17 CFR 240.10b-10.

that an SBS transaction is cleared through the facilities of clearing agency that matches or compares the terms of the transaction. Regardless of how the trade acknowledgment obligation is satisfied however, a trade acknowledgment would be required to be provided within 15 minutes, 30 minutes or 24 hours following execution, depending on whether the transaction is executed and/or processed electronically.<sup>49</sup>

Paragraph (d) of proposed rule 15Fi-1 would require that trade acknowledgments be provided through electronic means and lists the 22 data elements that must be included on each confirmation.<sup>50</sup> Paragraph (e)(1) of proposed rule 15Fi-1 would require SBS Entities to establish, maintain, and enforce policies and procedures reasonably designed to obtain prompt verification of SBS trade acknowledgments. If a transaction is cleared through a clearing agency, paragraph (e)(2) of the proposed rule would also require SBS Entities to comply with the clearing agency's verification procedures. Regardless of the method of transmittal, when an SBS Entity receives a trade acknowledgment, pursuant to paragraph (e)(3) of the proposed rule, it must promptly verify the accuracy of the trade acknowledgment or dispute the terms with its counterparty. Paragraph (a) of the proposed rule would define relevant terms and would not be a "collection of information"

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<sup>49</sup> Under proposed Rule 15Fi-1(c)(1)(i), any transaction that is executed and processed electronically would have to be acknowledged within 15 minutes of execution. Transactions that are not electronically executed but processed electronically would have to be acknowledged within 30 minutes of execution. See proposed Rule 15Fi-1(c)(1)(ii). Finally, proposed Rule 15Fi-1(c)(1)(ii) would require that all other transactions be acknowledged within 24 hours of execution. Proposed paragraph (c)(2) of the rule however, would require that transactions be processed electronically if the counterparties have the ability to do so. As the market for derivatives develops further however, the Commission believes that most SBS transactions will be processed electronically.

<sup>50</sup> See proposed Rule 15Fi-1(d) (1) through (22). See also discussion in Section II.C. supra.

within the meaning of the PRA. Similarly, paragraph (f) is an exemptive provision and would not be a collection of information.

### **B. Proposed Use of Information**

The trade acknowledgment and verification requirements of proposed rule 15Fi-1 would 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 counterparties addressing the obligation to send a trade acknowledgment. Generally, the transaction details that would be provided in a proposed rule 15Fi-1 trade acknowledgment would serve as a written record by which the counterparties to a transaction memorialize the economic and related terms of a transaction. In effect, the trade acknowledgment would reflect the contract entered into between the counterparties. In addition, proposed rule 15Fi-1's verification requirements are intended to assure 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 where an SBS Entity is provided a trade acknowledgment that is not an accurate reflection of the agreement, proposed rule 15Fi-1 would require the SBS Entity to dispute the terms of the transaction.

### **C. Respondents**

Proposed rule 15Fi-1 would only apply to SBS Entities, that is to SBS dealers and major SBS participants, both of which would be registered with the Commission. Based on the Commission staff's discussions with industry participants and incorporated in our other Dodd-Frank Act related rulemaking, we preliminarily believe that approximately 50 entities may fit within the definition of SBS dealer, and up to five entities may fit within

the definition of major SBS participant. Thus, approximately 55 entities may be required to register with the Commission as SBS Entities and thus, would be subject to the trade acknowledgment provision and verification requirements of proposed rule 15Fi-1.<sup>51</sup>

#### **D. Total Initial and Annual Reporting and Recordkeeping**

Pursuant to proposed rule 15Fi-1, all SBS transactions would have to be acknowledged and verified through the methods and by the timeframes prescribed in the proposed rule. Collectively, paragraphs (b), (c), (d) and (e) of proposed rule 15Fi-1 identify the information that is 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. According to the Depository Trust and Clearing Corporation (“DTCC”), there are on average 36,000 single-name credit-default swap (“CDS”) transactions per day,<sup>52</sup> resulting in a total number of 13,140,000 CDS transactions per year. The Commission preliminarily believes that CDSs represent 85% of all SBS transactions.<sup>53</sup> Assuming that at least one SBS Entity is a party to every SBS transaction, the Commission preliminarily estimates that the total number of SBS transactions that

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<sup>51</sup> We note that many clearing agencies already have facilities that would permit SBS Entities to acknowledge and verify SBS transactions in addition to other services provided by the clearing agency.

<sup>52</sup> See, e.g., [http://www.dtcc.com/products/derivserv/data\\_table\\_iii.php](http://www.dtcc.com/products/derivserv/data_table_iii.php) (weekly data as updated by DTCC).

<sup>53</sup> The Commission’s estimate is based on internal analysis of available SBS market data. The Commission is seeking comment about the overall size of the SBS market.



would be subject to proposed 15Fi-1 on an annual basis would be approximately 15,460,000 which is an average of 281,091 transactions per SBS Entity per year.<sup>54</sup>

Based on discussions with industry participants, the Commission estimates that approximately 99 percent, or 15,305,400 transactions,<sup>55</sup> are processed electronically, meaning that these transactions are either cleared through the facilities of a clearing agency,<sup>56</sup> or processed through an SBS Entity's internal electronic systems. The Commission believes that the remaining one percent of SBS transactions, or 154,600 transactions,<sup>57</sup> are currently not processed electronically, but are acknowledged and verified through other means, such as email, facsimile or other similar means.<sup>58</sup>

As discussed above, 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 (b)(2) of proposed rule 15Fi-1, which provides that SBS Entities will satisfy the requirement to provide a trade

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<sup>54</sup> These figures are based on the following:  $[13,140,000 / 0.85] = 15,458,824$ , or approximately 15,460,000.  $(15,460,000 \text{ estimated SBS transactions}) / (55 \text{ SBS Entities}) = 281,091 \text{ SBS transactions per SBS Entity per year}$ . The Commission understands that many of these transactions may arise from previously executed SBS transactions.

<sup>55</sup>  $15,460,000 \text{ SBS transactions} \times .99 = 15,305,400 \text{ transactions}$ .

<sup>56</sup> See discussion in Part II.A.2 *supra*.

<sup>57</sup>  $15,460,000 \text{ SBS transactions} \times .01 = 154,600 \text{ transactions}$ .

<sup>58</sup> We note that proposed rule 15Fi-1(c)(2) would require that SBS transactions be processed electronically if the acknowledging entity has the ability to do so. As noted above, the Commission believes that as this market develops further, fewer SBS Entities will lack the ability to process SBS transactions electronically. See also note 50 *supra*.

acknowledgment if a clearing agency produces a confirmation through its facilities. Nevertheless, the Commission believes that it will be necessary for SBS Entities, if they have not already done so, to develop computerized systems for inputting the terms of an SBS transaction and then transmitting that data to the relevant clearing agency for electronic processing.

The Commission also believes that such computerized systems will necessarily have to be programmed so that SBS transactions that are not electronically processed through the facilities of a clearing agency can be processed internally. Indeed, it is the Commission's understanding, through publicly available information and discussions with industry participants, that many SBS Entities may already have these types of systems in place.

Because this information is anecdotal, for the purposes of the PRA, the Commission assumes 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 believes that SBS Entities will have to develop internal order and trade management systems ("OMS") that will be connected or linked to the facilities of a clearing agency and that will also be able to process SBS transactions internally if necessary.<sup>59</sup> The Commission believes that those systems will also have front-office and back-office linkages that will permit the front

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<sup>59</sup> The Commission believes that systems for acknowledging and verifying SBS transactions will likely be an additional functionality of an OMS that SBS Entities would have to use to report SBS transactions to an SBS data repository. See SBSR Proposing Release, note 16 supra.

office to input SBS transaction details<sup>60</sup> and to send these updates in real-time or near real-time to the back-office so that complete packages of information can be sent to the clearing agency for electronic processing and timely acknowledgment, or in the alternative, so that the relevant SBS Entity can itself electronically process the transaction and send the required trade acknowledgment.

Based on our staff's discussions with industry participants and incorporated in our other Commission rulemaking related to the Dodd-Frank Act,<sup>61</sup> the Commission preliminarily estimates that the development of an OMS by SBS Entities 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>62</sup> This 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 preliminarily estimates that proposed rule 15Fi-1 would impose an ongoing annual hour burden of approximately 23,980 hours or 436 hours per SBS Entity.<sup>63</sup> This

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<sup>60</sup> The Commission understands that in some instances, additional transaction details may have to be entered post-execution but prior to processing. In the industry, this process generally referred to as "enrichment."

<sup>61</sup> See SBSR Proposing Release, note 16 supra, at Section XIII.B.4.a.

<sup>62</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 computerized systems in place for electronically processing SBS transactions, whether internally or through a clearing agency. This may result in lesser burdens for those parties

<sup>63</sup> This estimate is based on Commission staff discussions with market participants and is calculated as follows: [((Sr. Programmer at 32 hours) + (Sr. Systems

estimate would include 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 (e)(1) of proposed rule 15Fi-1, SBS Entities must establish, maintain, and enforce written policies and procedures reasonably designed to obtain prompt verification of transaction terms. While the cost of these policies and procedures will vary, the Commission estimates that such 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>64</sup> Once these policies and procedures are established, the Commission estimates that it will take an average 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>65</sup>

#### **E. Recordkeeping Requirements**

Pursuant to amendments to the Exchange Act from Title VII of the Dodd-Frank Act, the Commission plans to propose separate rules for SBS transactions that include, among other things, recordkeeping and transaction reporting requirements. Because a trade acknowledgment will serve as a written record of the transaction, the information

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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>64</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>65</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.

required by proposed Rule 15Fi-1 would be required to be maintained by an SBS Entity subject to those rules. This requirement will be subject to a separate PRA submission under that rulemaking.

#### **F. Collection of Information is Mandatory**

Each collection of information discussed above would be a mandatory collection of information.

#### **G. Will Responses of Collection of Information be Kept Confidential?**

By its terms, information collected pursuant to proposed rule 15Fi-1 will not be available to the public. Under other rules proposed by the Commission, however, most, if not all, of the information required to be included in a trade acknowledgment, as described in paragraph (d) of the proposed rule, will be otherwise publicly available. In particular, under proposed Regulation SBSR,<sup>66</sup> SBS Entities would be required to report SBS transaction details to a 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 the provisions of the Freedom of Information Act.

#### **H. Request for Comment**

The Commission requests comment on all aspects of its burden estimates. The Commission also solicits comment as follows:

58. Is the proposed collection of information necessary for the performance of the functions of the agency? Would the information have a practical utility?

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<sup>66</sup> See SBSR Proposing Release, note 16 supra.

59. How accurate are the Commission's preliminary estimates of the burdens of the proposed collection of information associated with proposed rule 15Fi-1? How many entities would incur collection of information burdens pursuant to rule 15Fi-1?
60. Would SBS Entities incur any additional burdens associated with designing, creating and implementing a system for the processing, acknowledgment and verification of SBS transactions pursuant to proposed rule 15Fi-1?
61. Would there be different or additional burdens associated with the collection of information under proposed rule 15Fi-1 that an SBS Entity would not undertake in the ordinary course of business?
62. Are there additional burdens that the Commission has not addressed in its preliminary burden estimates?
63. Are there ways to enhance the quality, utility and clarity of the information to be collected?
64. Are there ways to minimize the burden of collection of information on those who would be required to respond, including through the use of automated collection techniques or other forms of information technology?
65. What entities may be subject to proposed rule 15Fi-1? Would specific classes of entities be impacted? How many entities would be impacted? Will any entity or class of entities be impacted differently than others?

**V. Cost-Benefit Analysis**

The Dodd-Frank Act was enacted, in part, to promote the financial stability of the

United States by improving accountability and transparency in the financial system.<sup>67</sup>

Title VII of the Dodd-Frank Act designates the Commission to oversee the SBS markets and develop appropriate regulations. In furtherance of this goal, the Dodd-Frank Act added Section 15F(i) to the Exchange Act, which requires SBS Entities to “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,” and provides that the Commission must adopt rules governing those documentation standards. Accordingly, proposed rule 15Fi-1 would provide these documentation standards with respect to the timely and accurate provision of trade acknowledgments and verification of SBS transactions by SBS Entities.

The market for OTC derivatives, which has been described as opaque,<sup>68</sup> has grown exponentially in recent years<sup>69</sup> and is capable of affecting significant sectors of the U.S. economy. One of the primary goals of Title VII of the Dodd-Frank Act is to increase the transparency and efficiency of the OTC derivatives market and to reduce the

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<sup>67</sup> See Pub. L. No. 111-203 Preamble.

<sup>68</sup> With respect to CDSs, for example, the GAO found that “comprehensive and consistent data on the overall market have not been readily available,” that “authoritative information about the actual size of the CDS market is generally not available,” and that regulators currently are unable “to monitor activities across the market.” GAO, “Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps,” GAO-09-397T (March 2009), at 2, 5, 27.

<sup>69</sup> The Bank for International Settlements semi-annual reports on the swap markets summarizes developments in the OTC derivatives markets. The report breaks down trading volumes and other statistics for various classes of derivatives, including credit default swaps, interest rate and foreign exchange derivatives, and equity and commodity derivatives. The report covers derivatives trading within the G10 countries. The most recent report, available at <http://www.bis.org/statistics/derstats.htm>, covers the period through the last quarter of 2009.

potential for counterparty and systemic risk.<sup>70</sup> With respect to the confirmation of OTC derivatives transactions, the GAO noted that the trading volume of credit derivatives, such as SBS, had expanded so rapidly that the operational infrastructure and confirmation practices of many SBS Entities had failed to keep pace with the increased volume.<sup>71</sup> In particular, the GAO noted, among other things, that the lack of automated systems for confirming and verifying the terms of SBS transactions contributed to a significant backlog of unconfirmed transactions, which in turn created significant legal and operation risk for market participants.<sup>72</sup> As a result, these risks and other operational issues associated with OTC derivatives have been the focus of reports and recommendations by the President’s Working Group,<sup>73</sup> and of ongoing efforts to by the FRBNY<sup>74</sup> to enhance operational systems in the OTC market, including the reduction of confirmation backlogs and the timely provision of confirmations and verification of transactions in OTC derivatives.

Proposed rule 15Fi-1 would prescribe standards for the documentation and timely provision of SBS trade acknowledgments and the verification of such trade acknowledgments. More specifically, proposed Rule 15Fi-1 would require SBS Entities to provide a trade acknowledgment of an SBS transaction within 15 minutes, 30 minutes

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<sup>70</sup> See “Financial Regulatory Reform – A New Foundation: Rebuilding Financial Supervision and Regulation,” U.S. Department of the Treasury, at 47-48 (June 17, 2009).

<sup>71</sup> See GAO Confirmation Report, supra, note 6 and accompanying text.

<sup>72</sup> Id. at pages 12-15.

<sup>73</sup> See, e.g., Press Release, President’s Working Group on Financial Markets, Progress Summary on OTC Derivatives Operational Improvements (November 2008).

<sup>74</sup> See, note 10, supra.



or 24 hours following execution of the transactions, depending on whether the transaction is executed and/or processed electronically.<sup>75</sup> In addition, the proposed rule would require SBS Entities to include specified information in the trade acknowledgment,<sup>76</sup> to verify transactions with other SBS Entities, and to establish, maintain, and enforce reasonable written policies and procedures for verifying the transaction terms. The proposed rule would require most SBS transactions to be processed and acknowledged electronically if the SBS Entity has the ability to do so, but also would provide that many of the requirements of the rule can be satisfied through the facilities of the clearing agency that clears an SBS transaction.

#### **A. Benefits**

The Commission believes that proposed rule 15Fi-1 would yield substantial benefits to the SBS market and address many of the concerns noted by the GAO regarding the timely and accurate acknowledgment of OTC derivatives transactions. In particular, by requiring SBS Entities to timely provide trade acknowledgments and verify SBS transactions and to use electronic means when possible, the Commission is addressing the concern raised by the GAO regarding the legal and operational risks associated with confirmation backlogs in the OTC derivatives markets. In particular, the GAO noted in its report that the lack of automation was a significant contributor to confirmation backlogs.<sup>77</sup> The Commission believes that requiring SBS transactions to be processed electronically would help reduce what the GAO described as the operational and legal risks accompanying unconfirmed derivatives transactions. In addition, the

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<sup>75</sup> See note 49 *supra*.

<sup>76</sup> See note 50 *supra*. See also proposed Rule 15Fi-1(c)(1).

<sup>77</sup> See GAO Confirmation Report, *supra* note 6.

Commission believes that permitting SBS Entities to rely on the facilities of a clearing agency to satisfy their requirements under the proposed rule will encourage these entities to use clearing agency facilities, thereby promoting efficiency and automation in this market.

## **B. Costs**

Proposed rule 15Fi-1 would impose initial and ongoing costs on SBS Entities. The Commission believes that these costs will be a function of number of SBS transactions entered into by SBS Entities, whether SBS Entities have the ability to electronically process SBS transactions, and whether SBS Entities will enter into SBS transactions that can be, and are, cleared by a clearing agency.

The Commission obtained information from publicly available sources and consulted with industry participants in an effort to quantify the number of aggregate SBS transactions on an annual basis. According to the DTCC, there are on average 36,000 single-name CDS transactions per day,<sup>78</sup> resulting in a total number of 13,140,000 CDS transactions per year. The Commission preliminarily believes that CDSs represent 85% of all SBS transactions.<sup>79</sup> Therefore, the Commission preliminarily believes that there will be a total of approximately 15,460,000 SBS transactions entered into each year. Assuming that at least one SBS Entity is a party to every SBS transaction, the Commission preliminarily estimates that the total number of SBS transactions that would be subject to proposed 15Fi-1 on an annual basis would be approximately 15,460,000

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<sup>78</sup> See, e.g., [http://www.dtcc.com/products/derivserv/data\\_table\\_iii.php](http://www.dtcc.com/products/derivserv/data_table_iii.php) (weekly data as updated by DTCC).

<sup>79</sup> The Commission's estimate is based on internal analysis of available SBS market data. The Commission is seeking comment about the overall size of the SBS market.

which is an average of 281,091 transactions per SBS Entity per year.<sup>80</sup>

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. The development of an OMS would have to occur regardless of whether an SBS transaction is, or can be, cleared by a clearing agency.

The Commission preliminarily estimates that an SBS Entity's' development of an OMS that achieves compliance with proposed rule 15Fi-1 would impose a one-time aggregate cost of \$3,665,750,<sup>81</sup> or approximately \$66,650 per SBS Entity. This estimate includes the development of an OMS that leverages off of an SBS Entities' existing front-office and back-office operational platforms. The Commission further preliminarily estimates that the requirements of proposed rule 15Fi-1 would impose an ongoing annual aggregate cost of \$4,022,920, or approximately \$73,144 per SBS Entity.<sup>82</sup> This estimate

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<sup>80</sup> These figures are based on the following:  $[13,140,000 / 0.85] = 15,458,424$ , or approximately 15,460,000.  $(15,460,000 \text{ estimated SBS transactions}) / (55 \text{ SBS Entities}) = 309,200 \text{ SBS transactions per SBS Entity per year}$ . The Commission understands that many of these transactions may arise from previously executed SBS transactions.

<sup>81</sup> This estimate is based on the following:  $[(\text{Sr. Programmer (160 hours) at } \$285 \text{ per hour}) + (\text{Sr. Systems Analyst (160 hours) at } \$251 \text{ per hour}) + (\text{Compliance Manager (10 hours) at } \$294 \text{ per hour}) + (\text{Director of Compliance (5 hours) at } \$426 \text{ per hour}) + (\text{Compliance Attorney (20 hours) at } \$291 \text{ per hour}) \times (50 \text{ SBS Entities})] = \$3,665,750 \text{ or } \$66,650 \text{ per SBS Entity}$ . 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>82</sup> This estimate is based on Commission staff discussions with market participants and is calculated as follows:  $[(\text{Sr. Programmer (32 hours) at } \$285 \text{ per hour}) + (\text{Sr. Systems Analyst (32 hours) at } \$251 \text{ per hour}) + (\text{Compliance Manager (60 hours) at } \$294 \text{ per hour}) + (\text{Compliance Clerk (240 hours) at } \$59 \text{ per hour}) + (\text{Director of Compliance (24 hours) at } \$426 \text{ per hour}) + (\text{Compliance Attorney (48$

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 (e)(1) of the proposed rule would impose initial costs of \$1,754,500, or approximately \$31,900 per SBS Entity.<sup>83</sup> Once established, the Commission estimates that it would cost respondents approximately \$877,250 per year, or \$15,950 per respondent,<sup>84</sup> to update and maintain these policies and procedures.

In sum, the Commission estimates that the initial cost of complying with proposed rule 15Fi-1 will be \$5,417,500 for all respondents, or \$98,500 per SBS Entity.<sup>85</sup> The Commission estimates that total ongoing costs to respondents would be \$4,900,170 for all respondents, or \$89,094 per SBS Entity.<sup>86</sup>

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hours) at \$291 per hour) x (55 SBS Entities)] = \$4,022,920 burden hours, or \$73,144 per SBS Entity.

<sup>83</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) x (55 SBS Entities)] = \$1,754,500 total, or \$31,900 per SBS Entity.

<sup>84</sup> This estimate comes from Commission staff experience regarding the development 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) x (55 SBS Entities)] = \$877,250 total, or \$15,950 per SBS Entity.

<sup>85</sup> (\$3,665,750 initial cost for developing OMS) + (\$1,754,500 for developing policies and procedures) = \$5,417,500 for all respondents. (\$5,417,500 / 505 Respondents) = \$98,500 per SBS Entity.

<sup>86</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.

### **C. Request for Comment**

The Commission requests comment on the costs and benefits of proposed rule 15Fi-1 discussed above, as well as any costs and benefits not already described that could result.

In addition, the Commission requests comment on the following:

66. How can the Commission accurately estimate the costs and benefits of the proposed rule?
67. What are the costs currently borne by SBS Entities that would be subject to proposed rule 15Fi-1 with respect to the acknowledgment and verification of SBS transactions?
68. How many entities would be subject to the proposed rule? How transactions would be subject to the proposed rule?
69. Are there additional costs involved in complying with the rule that have not been identified? What are the types, and amounts, of the costs?
70. Would the obligations imposed on SBS Entities by proposed rule 15Fi-1 be a significant enough barrier to cause some firms not to enter the SBS market? If so, how many firms might decline to enter the market? How could the cost of their not entering the market be measured? How should the Commission weigh those costs, if any, against the anticipated benefits from reducing legal and operational risk to SBS Entities from the proposal, as discussed above?
71. Would there be additional benefits from the proposed rule that have not been identified?

## **VI. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation**

Exchange Act Section 3(f) requires the Commission, when engaging in rulemaking that requires it to consider whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact of those rules on competition. Section 23(a)(2) also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The Commission preliminarily believes that the documentation standards for the provision of trade acknowledgments and verification of SBS transactions, as required by the Dodd-Frank Act and implemented by proposed rule 15Fi-1, would promote efficiency, competition, and capital formation by encouraging SBS Entities to automate their systems for SBS transactions, providing further incentive for SBS Entities to clear SBS transactions through clearing agencies' automated facilities, thus lowering transaction costs, and helping alleviate the legal and operational risks encountered by SBS Entities when SBS transactions are otherwise confirmed through manual methods.

The Commission's experience with the acknowledgment and verification of other types of securities is that the timely resolution of disputes regarding the terms of a transaction are more efficiently handled near in time to when the transaction took place. Timely acknowledgment and verification of SBS transactions will provide counterparties with the appropriate means by which to evaluate their own risk exposures in a timely

manner, thereby enabling them to more quickly and efficiently determine whether and how to deploy capital in other asset classes. In addition, the Commission believes that competition will be promoted because market participants would be encouraged to enter into SBS transactions with SBS Entities whose automated operations reduce the amount of time it takes to confirm the terms of a trade. In particular, the Commission believes that the need for speed and efficiency in today's capital markets would encourage market participants in general, and SBS Entities in particular, to provide quicker and more efficient process for confirming SBS transactions because counterparties to an SBS transaction must not only concern themselves with the SBS transaction, but also the underlying reference security that itself is subject to rapid market movements.

## **VII. Consideration of Impact on the Economy**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"), the Commission must advise the OMB whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" when, if adopted, it results or is likely to result in: (1) an annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation. If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

The Commission requests comment on the potential impact of proposed rule 15Fi-1 on the economy on an annual basis, on the costs or prices for consumers or individual industries, and on competition, investment, or innovation. Commenters are

requested to provide empirical data and other factual support for their view to the extent possible.

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

The Regulatory Flexibility Act (“RFA”) requires federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a) of the Administrative Procedure Act, as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on “small entities.” Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule or proposed rule amendment which, if adopted, would not have a significant economic impact on a substantial number of small entities.

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (1) when used 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; or (2) 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, 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.



Based on our staff's discussions with SBS market participants, the Commission preliminarily believes that the majority of SBS transactions have at least one counterparty that is either a SBS dealer or major SBS participant, and that these entities – whether registered broker-dealers or not – would exceed the thresholds defining “small entities” set out above. Accordingly, neither of these types of entities would likely qualify as small entities for purposes of the RFA. Moreover, even in situations in which one of the counterparties to a SBS is not covered by these definitions, the Commission preliminarily does not believe that any such entities would be “small entities” as defined in Commission Rule 0-10. Industry participants have indicated to our staff that only persons or entities with assets significantly in excess of \$5 million participate in the SBS market. For example, as stated in a current survey conducted by Office of the Comptroller of the Currency, 99.9% of CDS positions by U.S. commercial banks and trusts are held by those with assets over \$10 billion.<sup>87</sup> Given the magnitude of this figure, and the fact that it so far exceeds \$5 million, the Commission preliminarily believes that the vast majority of, if not all, SBS transactions do not involve small entities for purposes of the RFA.

In addition, the Commission preliminarily believes that the entities likely to register as SBS Entities would not be small entities. Industry participants have indicated to our staff that most if not all of the registered SBS Entities would be part of large business entities, and that all registered SBS Entities would have assets exceeding \$5 million and total capital exceeding \$500,000. Therefore, the Commission preliminarily believes that none of the SBS Entities would be small entities.

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<sup>87</sup> See Office of the Comptroller of the Currency, “Quarterly Report on Bank Trading and Derivatives Activities Second Quarter 2010” (2010).

On this basis, the Commission preliminarily believes that the number of SBS transactions involving a small entity as that term is defined for purposes of the RFA would be de minimis. Moreover, the Commission does not believe that any aspect of proposed rule 15Fi-1 would be likely to alter the type of counterparties presently engaging in SBS transactions. Therefore, the Commission preliminarily does not believe that proposed rule 15Fi-1 would impact any small entities.

For the foregoing reasons, the Commission certifies that proposed Rule 15Fi-1 would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities, indicate whether they believe that SBS Entities are unlikely to be small entities, and provide empirical data to support their responses.

#### **IX. Statutory Basis and Text of Proposed Amendments**

The Commission is proposing to adopt Rule 15Fi-1 pursuant to Section 15F of the Exchange Act, as amended.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities, Security-based swaps, Security-based Swap Dealers, Major Security-based Swap Participants.

In accordance with the foregoing, the Securities and Exchange Commission is proposing to amend 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 is revised to read as follows::

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78o-4, 78o-8, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et. seq.; and 18 U.S.C. 1350, and 12 U.S.C. 5221(e)(3) unless otherwise noted.

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2. Add an undesignated center heading following § 15Cc1-1 and § 240.15Fi-1 to read as follows:

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

**§ 240.15Fi-1 Acknowledgment and verification of security-based swap transactions.**

(a) Definitions. For the purposes of this section:

(1) The term asset class means those security-based swaps in a particular broad category, including, but not limited to, credit derivatives, equity derivatives, and loan-based derivatives.

(2) The term broker ID means the UIC assigned to a person acting as a broker for a participant.

(3) The term clearing agency means a clearing agency registered pursuant to section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1).

(4) The term confirmation means a trade acknowledgment that has been subject to verification.

(5) The term desk ID means the UIC assigned to the trading desk of a participant or of a broker of a participant.

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

(7) The term participant ID means the UIC assigned to a participant.

(8) The term price means the price of a security-based swap transaction, expressed in terms of the commercial conventions used in that asset class.

(9) The term processed electronically means entered into a security-based swap dealer or security-based swap participant's computerized processing systems to facilitate clearance and settlement.

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

(11) The term trader ID means the UIC assigned to a natural person who executes security-based swaps.

(12) The term unique identification code or UIC means the unique identification code assigned to a person, unit of a person, or product by or on behalf of an internationally recognized standards-setting body that imposes fees and usage restrictions that are fair and reasonable and not unreasonably discriminatory. 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.

(13) 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.

(b) Trade Acknowledgment Requirement.

(1) 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:

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

(ii) 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

(iii) The counterparty that the counterparties have agreed will provide the trade acknowledgment in any transaction other than one described in paragraph (i) or (ii) of this section.

(2) A security-based swap dealer or major security-based swap participant will have satisfied the requirements of paragraph (b)(1) of this section if a clearing agency through its facilities produces a confirmation of each security-based swap transaction.

(c) Prescribed Time.

(1) Any trade acknowledgment required by paragraph (b) of this section must be provided promptly, but in any event:

(i) For any transaction that has been executed and processed electronically, within 15 minutes of execution;

(ii) For any transaction that is not executed electronically, but that will be processed electronically, within 30 minutes of execution; or

(iii) For any transaction that cannot be processed electronically by the security-based swap dealer or security-based swap participant, within 24 hours following execution.

(2) A transaction must be processed electronically if the security-based swap dealer or major security-based swap participant has the ability to do so.

(d) Form and Content of Trade Acknowledgment. Any trade acknowledgment required in paragraph (b) of this section must be provided through electronic means that provide reasonable assurance of delivery and a record of transmittal, and must disclose:

(1) The asset class of the security-based swap and, if the security-based swap is an equity derivative, whether it is a total return swap or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the security-based swap is based;

(2) Information that identifies the security-based swap instrument and the specific asset(s) or issuer of a security on which the security-based swap is based;

(3) The notional amount(s), and the currenc(ies) in which the notional amount(s) is expressed;

(4) The date and time, to the second, of execution expressed using Coordinated Universal Time (UTC);

(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 will be cleared by a clearing agency;

(10) If both counterparties to a security-based swap are security-based swap dealers, an indication to that effect;

(11) If the transaction involved an existing security-based swap, an indication that the transaction did not involve an opportunity to negotiate a material term of the contract, other than the counterparty;

(12) If the security-based swap is customized to the extent that the information provided in paragraphs (d)(1) through (11) of this section does not provide all of the material information necessary to identify such customized security-based swap or does not contain the data elements necessary to calculate the price, an indication to that effect;

(13) The participant ID of each counterparty;

(14) As applicable, the broker ID, desk ID, and trader ID of the reporting party;

(15) The amount(s) and currenc(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 (including the title of any document governing the satisfaction of margin obligations), 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 security-based swap will be cleared, the name of the clearing agency;

(19) If the security-based swap 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 security-based swap 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 the settlement value;

(21) The venue where the security-based swap was executed; and

(22) If the transaction is to be cleared, any additional information that is required for the transaction to be cleared by a clearing agency.

(e) 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 (b) of this section.

(2) In any security-based swap transaction to be cleared through a clearing agency, a security-based swap dealer or major security-based swap participant must comply with the verification process prescribed by the clearing agency. Such compliance shall satisfy the requirements of paragraph (e)(1) of this section with respect to the transaction.

(3) 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 (b) of this section.

(f) Exemption from § 240.10b-10. A security-based swap dealer or major security-based swap participant who is also a broker or dealer and who complies with



paragraph (b) of this section with respect to a security-based swap transaction is exempt from the requirements of § 240.10b-10 of this chapter with respect to the security-based swap transaction.

By the Commission.

Elizabeth M. Murphy  
Secretary

Dated: January 14, 2011