

MEMO# 31753

May 9, 2019

CFTC Proposes Amendments to Swap Data Reporting Requirements and DCO Rules

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May 9, 2019 TO: Derivatives Markets Advisory Committee RE: CFTC Proposes Amendments to Swap Data Reporting Requirements and DCO Rules

The Commodity Futures Trading Commission (CFTC or “Commission”) recently proposed amendments to improve the accuracy of swap data reported to, and maintained by, swap data repositories (SDRs).^[1] Comments on the proposed amendments are due 75 days after publication in the *Federal Register*. The CFTC separately proposed amendments to its regulations applicable to registered derivatives clearing organizations (DCOs).^[2] Comments on those proposed amendments are due 60 days after publication in the *Federal Register*. We have summarized below those aspects of the CFTC’s proposals most relevant to registered investment companies (“funds”).

We will discuss member views on the CFTC’s proposals at our May 15th in-person meeting of ICI’s Derivatives Markets Advisory Committee. If you are unable to attend the meeting and have comments on the proposed amendments, please contact Sarah Bessin at sarah.bessin@ici.org by May 24th.

Amendments to Swap Data Reporting Rules

Background

In 2011, the CFTC adopted regulations relating to the reporting of swap data, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). One set of regulations provided for real-time public reporting of swap transaction and pricing data pursuant to part 43 of the CFTC’s regulations, while another set out the requirements for swap data recordkeeping and reporting to SDRs, pursuant to part 45 of the Commission’s regulations.^[3] Also in 2011, the CFTC adopted rules regarding registration requirements and duties for SDRs, pursuant to part 49 of the Commission’s regulations. In 2012, the CFTC adopted part 23 of its regulations, which set out requirements for swap dealers (SDs) and major swap participants (MSPs) related to the timely and accurate reporting, confirmation, and processing of swaps.

In 2017, the CFTC released its *Roadmap to Achieve High Quality Swaps Data*

(“Roadmap”).^[4] The Roadmap contemplated that the CFTC would review its reporting regulations (i) to ensure that it receives accurate, complete, and high-quality data on swaps transactions for its regulatory oversight role; and (ii) to streamline reporting, reduce messages that must be reported, and right-size the number of data elements that are reported to meet the agency’s priority use-cases for swaps data. The current proposal is intended to address the first of these goals and is the first of three anticipated rulemakings intended to achieve the Roadmap’s goals.

When the Commission proposes the next two rulemakings, it plans to re-open the comment period for this proposal to provide market participants with an opportunity to comment collectively on the three rulemakings. The Commission anticipates that key provisions of each rulemaking would have the same compliance date, regardless of when each rulemaking is released in final form.

Proposed Verification Obligations

The Commission proposes to add requirements for SDRs and reporting counterparties^[5] to verify the accuracy and completeness of swap data that is reported to the SDR. Currently, SDRs are required to establish and adopt policies and procedures to ensure the accuracy of swap data and other information reported to them. The SDR must confirm the accuracy and completeness of all swap data submitted pursuant to part 45, with the exception of swap data received from a swap execution facility (SEF), designated contract market (DCM), DCO, or a third-party service provider acting on behalf of a swap counterparty, if certain conditions are met.^[6] The CFTC explains that, to satisfy these obligations, SDRs have adopted rules based on the concept of negative affirmation—SDRs typically treat reported swap data as accurate and confirmed if a counterparty does not inform the SDR of errors or omissions or otherwise make modifications to a trade record for a certain period of time.^[7]

The CFTC is concerned that SDRs not obtaining affirmative confirmation of swap data has had a negative effect on swap data accuracy and consistency. Accordingly, the Commission is proposing that SDRs affirmatively verify swap data with reporting counterparties. Importantly, the CFTC proposes that the verification obligation would apply only to reporting counterparties, recognizing that reporting counterparties are in the best position to verify swap data with SDRs, and that it would be burdensome and inconsistent with the CFTC’s swap data reporting requirements to impose this obligation on non-reporting counterparties. The Commission requests comment on this approach.^[8]

The Commission would require that an SDR distribute to each reporting counterparty an open swaps report detailing the swap data maintained by the SDR for all open swaps. SDRs would be required to distribute the open swaps report to SD/MSP/DCO reporting counterparties on a weekly basis, and to non-SD/MSP/DCO reporting counterparties on a monthly basis, based on the Commission’s understanding that non-SD/MSP/DCO reporting counterparties tend to be less active in the swaps markets with fewer resources to devote to regulatory compliance.

In response to an open swaps report, a reporting counterparty would be required to provide the SDR with either a verification of data accuracy or a notice of discrepancy indicating that the data contained in an open swaps report contains one or more discrepancies.

The CFTC proposes conforming amendments to part 45 that would require reporting counterparties to verify swap data. The amended regulations would require that reporting counterparties submit either a verification of data accuracy or a notice of discrepancy in

response to each open swaps report received from an SDR within the following timeframes: (i) 48 hours of the SDR providing the open swaps report if the reporting counterparty is an SD, MSP, or DCO; or (ii) 96 hours of the SDR providing the open swaps report to non-SD/MSP/DCO reporting counterparties.[\[9\]](#)

Proposed Error Correction Obligations

Currently, SEFs, DCMs, and reporting counterparties are required to correct errors and omissions in swap data that was previously reported to an SDR or was not reported as required, as soon as technologically practicable following discovery of the errors or omissions.[\[10\]](#) Under current regulations, non-reporting counterparties that discover swap data errors or omissions must promptly notify the reporting counterparty, which is required to report a correction of the error or omission to the SDR. A similar obligation exists to correct errors and omissions in swap transaction and pricing data that was publicly disseminated.[\[11\]](#) Under these rules, non-reporting counterparties that become aware of an error or omission in reported swap transaction and pricing data must promptly notify the reporting party of the error or omission.

The CFTC proposes several changes to the error and omission correction requirements for swap data reported to an SDR. First, the Commission's error and omission correction requirements would apply regardless of the state of the swap, including swaps that are no longer open or "alive."[\[12\]](#) Second, the Commission proposes that the current time frame for correcting swap data "as soon as technologically practicable following discovery of the errors or omissions" would be limited to no more than three business days after discovery of the error or omission. Importantly, a non-reporting counterparty that becomes aware of any error or omission in swap data previously reported to an SDR would be required to notify the reporting counterparty of the errors or omissions as soon as technologically practicable, but no later than three business days after discovery.[\[13\]](#) Third, if a SEF, DCM, or reporting counterparty is unable to correct errors or omissions within three business days of discovery, the SEF, DCM or reporting counterparty must immediately inform the Director of the CFTC's Division of Market Oversight, or another CFTC designee, of the errors or omissions, and provide an initial assessment and initial remediation plan for correcting the errors or omissions. The Commission expects that a reporting counterparty that repeatedly discovers errors or omissions in the open swaps report will evaluate its reporting systems to discover any systemic errors or omissions, including working with the SDR to improve its data reporting, if needed.

The Commission proposes conforming amendments to the error and omission correction requirements applicable to real-time public reporting of swap transaction and pricing data under part 43.

Amendments to DCO Rules and Core Principles

Background

In 2011, the CFTC adopted regulations that established standards for compliance with the core principles applicable to DCOs.[\[14\]](#) Pursuant to its "Project KISS" initiative, the CFTC has proposed amendments to certain of these regulations to, among other things, enhance certain risk management and reporting obligations, clarify the meaning of certain provisions, simplify processes for DCO registration and reporting, and codify existing staff relief and guidance.[\[15\]](#) While most of the proposed amendments would not have direct implications for funds, we have summarized below several proposed provisions that may be

of particular interest.

Calculation of Customer Initial Margin Requirements

Regulation 39.13 implements DCO Core Principle D, which establishes risk management standards for DCOs. Currently, Regulation 39.13(g) requires a DCO to have initial margin requirements that are commensurate with the risks of each product and portfolio, including any unusual characteristics of, or risks associated with, particular products or portfolios. The rule requires a DCO to collect initial margin on a gross basis for each clearing member's customer account(s). The CFTC's Division of Clearing and Risk (DCR), in response to inquiries, previously advised DCOs that this provision requires a DCO to collect customer initial margin on a gross basis during any settlement cycle (end-of-day or intraday) in which the DCO collects customer initial margin.[\[16\]](#)

The Commission is concerned that requiring DCOs to collect initial margin intraday may present operational challenges. It therefore proposes to amend Regulation 39.13(g) to require a DCO to collect customer initial margin from its clearing members on a gross basis only during its end-of-day settlement cycle, although it encourages DCOs to collect customer initial margin intraday, if they are able to calculate the margin accurately.

Regulation 39.13(g) also provides that a DCO must require its clearing members to collect customer initial margin from their customers "for non-hedge positions, at a level that is greater than 100 percent of the [DCO's] initial margin requirements with respect to each product and swap portfolio." Based on interpretive relief DCR previously issued, the Commission proposes to revise Regulation 39.13(g) to delete the reference to "non-hedge" positions, change the reference to "a level that is greater than 100 percent" to "a level that is not less than 100 percent," clarify that the customer initial margin level is measured against "clearing" initial margin requirements, and explicitly state that customer initial margin levels must be "commensurate with the risk presented by each customer account."[\[17\]](#) The CFTC believes that it is inappropriate to establish a bright-line test to determine the percentage by which customer initial margin requirements must exceed clearing initial margin requirements with respect to any particular types of customer accounts because the circumstances for each DCO and the nature of its clearing members and their customers vary. The Commission requests comment on its approach, including whether it should add standards, provide guidance, or further clarify this determination.

DCO Cross-Margining Programs

The CFTC proposes to amend Regulation 39.13 to add a new subsection (i) that would codify the Commission's existing practices for evaluating DCO cross-margining arrangements. The Commission explains that it has issued a number of cross-margining program orders permitting a DCO to provide offsets or reductions in required margin between products that it and another DCO or other clearing organization clear. The proposed amendment is intended to codify the Commission's process by requiring a DCO to provide enumerated items of information regarding its proposed cross-margining program, pursuant to a rule filing submitted for Commission approval pursuant to Regulation 40.5. The CFTC requests comment on whether there are other factors it should consider or other information it should request, and whether a rule filing process is the appropriate process for approving such requests.

endnotes

[1] See *Proposed Amendments to the Commission's Regulations Relating to Certain Swap Data Repository and Data Reporting Requirements*, available at <https://www.cftc.gov/system/files/2019/04/25/federalregister042519.pdf> ("Swap Data Proposal"). Although Commissioner Stump voted to approve the Swap Data Proposal, she issued a lengthy concurring statement expressing significant concerns with key aspects of the proposal, including the following:

- The need for new verification procedures is questionable in the absence of evidence that a substantial problem exists.
- The proposed amendments are too vague to provide a sufficient basis for public comment.
- Some of the CFTC's policy choices are questionable, including requiring errors and omissions corrections even on dead/expired swaps.
- The sequencing of the proposal is problematic—the Commission should have issued this proposal in conjunction with the two subsequent rulemakings the Commission contemplates regarding swap data reporting.
- The proposal reflects a lack of harmonization with the SEC—the CFTC's approach to verification is inconsistent with the SEC's approach.
- The proposed amendments would impose an outsized burden on SDRs and reporting counterparties, including end-users. A significant number of non-SD/MSP/DCO reporting counterparties would have to commit considerable resources to comply with the amendments.

See *Statement of Concurrence of Commissioner Dawn D. Stump on Proposed Rule Amendments to The Commission's Regulations Relating to Certain Swap Data Repository and Data Reporting Requirements* (Apr. 25, 2019), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement042519>.

[2] See *Derivatives Clearing Organization General Provisions and Core Principles*, available at <https://www.cftc.gov/system/files/2019/04/29/federalregister042919.pdf> ("DCO Proposal").

[3] For a summary of these rules, please see ICI Memorandum No. 25757 (Dec. 29, 2011), available at https://www.ici.org/my_ici/memorandum/memo25757.

[4] Available at https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/dmo_swapdataplan071017.pdf.

[5] "Reporting counterparty" would mean the counterparty responsible for reporting SDR data to an SDR pursuant to parts 43, 45, or 46 of the CFTC's regulations. This is not a new concept; the CFTC intends to replace slightly different terms in some of these regulations with a single term. Under the CFTC's reporting hierarchy, regulated funds typically are not reporting counterparties but could be, for example, when transacting with a counterparty that is not registered as an SD (such as a dealer relying on the swap dealer *de minimis* exclusion). See ICI Memorandum No. 25757, *supra*.

[6] See Regulation 49.11(b).

[7] *Swap Data Proposal*, *supra* note 1, at 34.

[8] *Id.* at 45.

[9] See Regulation 45.14(a), as proposed to be amended.

[10] See Regulation 45.14.

[11] See Regulation 43.3(e).

[12] This may include swaps that have been terminated, matured, or otherwise have ceased to be open swaps. The Commission believes applying the correction requirements to such swaps is not a new requirement, as the current correction requirements of Regulation 45.14 do not have time restrictions. *Swap Data Proposal*, *supra* note 1, at 105, 113.

[13] The CFTC's regulations would provide that if a non-reporting counterparty does not know the identity of the reporting counterparty, it must notify the SEF or DCM where the swap was executed of the errors or omissions within the same time frame as described above. If the reporting counterparty, SEF, or DCM, as applicable, and the non-reporting counterparty agree that the swap data is incorrect or incomplete, the reporting counterparty, SEF, or DCM, as applicable, must correct the swap data.

[14] For a summary of these regulations, *please see* ICI Memorandum No. 25596 (Oct. 28, 2011), *available at* https://www.ici.org/my_ici/memorandum/memo25596. These regulations were issued to implement the Dodd-Frank Act's revision of the core principles for DCOs under the Commodity Exchange Act and its addition of several new ones.

[15] See *DCO Proposal*, *supra* note 2. Commissioner Berkovitz voted to approve the proposal, but issued a concurring statement in which he raised concerns, including that: (i) many of the proposed provisions are too general and do not provide specific guidance or standards; (ii) the proposed amendments provide little guidance on how a DCO should calculate initial margin requirements; and (iii) whether the information DCOs would be required to provide to the Commission to implement a cross-margining program is sufficient. See *id.* at 269.

[16] *Id.* at 40.

[17] The amended regulation would further provide the DCO with "reasonable discretion" to determine "whether and by how much such customer initial margin requirements must exceed the [DCO's] initial margin requirements with respect to particular products or portfolios."