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February 23, 2015

SEC Proposes Amendments to Regulation on Reporting and Dissemination of Security-Based Swap Information; Proposed Guidance on Bunched Orders

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 11-15
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 7-15 RE: SEC PROPOSES AMENDMENTS TO REGULATIONS ON REPORTING AND DISSEMINATION OF SECURITY-BASED SWAP INFORMATION; PROPOSED GUIDANCE ON BUNCHED ORDERS

Recently, the Securities and Exchange Commission ("SEC" or "Commission") proposed new rules and rule amendments to Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information ("Regulation SBSR") [1] – a new regulation that was adopted in a companion release. [2] The Proposed Rules would require a registered clearing agency to report to a registered swap data repository ("SDR") any security-based swap to which it is a counterparty. The Proposed Rules also would require a platform (i.e., a national securities exchange or security-based swap execution facility ("SB SEF")) to report to a registered SDR a security-based swap executed on the platform that will be submitted to clearing. The Proposed Rules would prohibit registered SDRs from charging fees for or imposing usage restrictions on the users of security-based swap transaction data that they are required to disseminate publicly. In addition, the Commission proposes guidance for the reporting and public dissemination of allocations of cleared security-based swaps and describes the application of Regulation SBSR to prime brokerage transactions. Finally, the Commission proposes a new compliance schedule for Regulation SBSR.

Comments on the Proposed Rules are due 45 days after publication of the proposing release in the Federal Register. A member call to discuss potential ICI comments is scheduled for Wednesday, March 4 at 12:00 p.m. ET. If you plan to attend the conference call, please respond to Kim Hair at kim.hair@ici.org or (202) 326-5818 to obtain the dial-in information.

This memorandum briefly highlights some of the relevant issues for registered funds.

Reporting by Clearing Agencies and Registered Platforms

The SEC is proposing amendments to Regulation SBSR to assign the reporting obligation for clearing transactions [3] and platform-executed security-based swaps that will be submitted to clearing.

Clearing Process

Under the agency model for clearing (which is the predominate model in the US swaps market), a swap that is accepted for clearing ("alpha") is terminated and replaced with two new swaps ("beta" and "gamma"). One of the direct counterparties to the alpha becomes a direct counterparty to the beta and the other direct counterparty to the alpha becomes a direct counterparty to the gamma. The clearing agency would be a direct counterparty to each of the beta and gamma.

Reporting by Registered Clearing Agencies

The SEC is proposing to assign the reporting duty for a clearing transaction to the registered clearing agency that is a counterparty to the security-based swap – the betas and gammas arising from clearing alpha security-based swaps. A registered clearing agency would be the reporting side for all transactions to which it is a counterparty, and it would have the ability to choose the registered SDR to which it would report.

The Proposed Rules also would require a registered clearing agency to report whether or not it has accepted an alpha security-based swaps for clearing. Under new Regulation SBSR, the reporting side for a security-based swap must generally report a life cycle event of that swap except that the reporting side shall not report whether or not a security-based swap has been accepted for clearing. In proposing this amendment, the SEC believes that it would be more efficient to require the registered clearing agency to report to the alpha SDR whether or not the registered clearing agency has accepted the alpha for clearing.

Reporting by Platforms

The Proposed Rules would require that, if a security-based swap is executed on a platform (i.e., alpha executed on the platform) and will be submitted to clearing, the platform on which the transaction was executed will have a duty to report the transaction to a registered SDR. This proposal, in part, is intended to address comments such as those of ICI that platforms and security-based swap dealers should be obligated to report security-based swap data rather than counterparties such as registered funds because registered funds would need to spend significant time and resources to build security-based swap reporting systems.

If the security-based swap will not be submitted to clearing, the platform would have no reporting obligations under Regulations SBSR. The reporting hierarchy in new Regulation SBSR will determine which side is the reporting side for such a platform-executed transaction.

Reporting and Public Dissemination of Security-Based Swaps Involving Bunched Orders and Allocations

The Regulation SBSR Adopting Release provides guidance for the reporting of certain security-based swaps executed by an asset manager on behalf of multiple clients ("bunched orders"). New Regulation SBSR requires a bunched order execution and the security-based swaps resulting from the allocation of the bunched order execution, if they are not cleared, to be reported like other security-based swaps. Regulation SBSR provides that the registered SDR to which the initial bunched order execution is reported must disseminate a report of the bunched order execution, including the full notional amount of the transaction. Regulation SBSR prohibits the registered SDR from publicly disseminating any information regarding the allocation of a bunched order execution, which would include the smaller security-based swaps resulting from the allocation of the initial transaction as well as the fact that the initial transaction is terminated following the allocation.

In the Proposed Rules, the Commission is proposing an interpretation for how Regulation SBSR would apply to a bunched order that will be submitted to clearing and the security-based swaps that result from the allocation of the bunched order.

Off-Platform Cleared Transaction

If a bunched order is executed bilaterally (off-platform), the reporting hierarchy in Regulation SBSR would apply to the bunch order alpha. When the reporting side submits a bunched order alpha to a registered clearing agency for clearing, the Proposed Rules would require the reporting side promptly to provide the registered clearing agency with the transaction ID of the bunched order alpha and the identity of the alpha SDR. The Commission is proposing these requirements to facilitate the registered clearing agency's ability to report whether or not it accepts the bunched order alpha for clearing.

The Proposed Rules would require a registered clearing agency to report all clearing transactions that arise as a result of clearing the bunched order alpha regardless of the workflows used to clear the bunched order alpha. If the asset manager provides allocation instructions prior to or contemporaneously with the clearing of the bunched alpha, clearing could result in the creation of a beta (the clearing transaction between the registered clearing agency and the security-based swap dealer) and a gamma series (the transactions between the registered clearing agency and each of the funds selected by the asset manager to receive a portion of the initial notional amount). Under the Proposed Rules, the beta and each security-based swap that comprises the gamma series would be treated the same under Regulation SBSR as other clearing transactions (as discussed above).

If the asset manager does not provide allocation instructions until after the bunched order alpha is cleared, clearing could result in the creation of a beta (the clearing transaction between the registered clearing agency and the security-based swap dealer) and an "intermediate gamma" (the clearing transaction between the clearing agency and the side representing the clients of the asset manager). The beta would be treated the same as any other clearing transaction while the intermediate gamma would continue to exist until the registered clearing agency receives the allocation information. As the registered clearing agency receives the allocation information, it would terminate the intermediate gamma and create new security-based swaps as part of the gamma series. Under the Proposed Rules, the partial terminations of the intermediate gamma would be life cycle events of the intermediate gamma that the registered clearing agency must report under Regulation SBSR. The registered clearing agency also would be required to report to a registered SDR each new security-based swap comprising part of the gamma series.

Cleared Platform Transaction

For bunched orders that are executed on an SB SEF and will be submitted to clearing, the Proposed Rules would require the platform to report the bunched order alpha to a registered SDR. If the platform does not know the counterparty IDs of each account that will receive an allocation, the platform could report the execution agent ID of the execution agent. [4]

If the asset manager provides allocation instructions prior to or contemporaneously with the clearing of the bunched order alpha, clearing under the agency model would result in the creation of a beta (the clearing transaction between the registered clearing agency and the registered security-based swap dealer) and a gamma series (the transactions between the clearing agency and each of the asset manager's clients). Under the Proposed Rules, the beta and each security-based swap that comprises the gamma series would be treated the same as other clearing transactions under Regulation SBSR.

If the asset manager does not provide allocation instructions until after the bunched order alpha is cleared, clearing would result in the creation of a beta (the clearing transaction between the registered clearing agency and the security-based swap dealer) and an intermediate gamma (the clearing transaction between the registered clearing agency and the side representing the clients of the asset manager). Under the Proposed Rules, the registered clearing agency would then be required to report the termination of the bunched order alpha and the creation of the beta and intermediate gamma. The Proposed Rule would treat the beta, the intermediate gamma, and the gamma series the same way as other clearing transactions are treated under Regulation SBSR (as discussed above).

Compliance Schedule

The Commission is proposing a new phased-in compliance schedule for Regulation SBSR, which is tied to the commencement of operations of a registered SDR in an asset class.

- Proposed Compliance Date 1: Six months after the first registered SDR that accepts reports of security-based swaps in a particular asset class commences operations as a registered SDR, persons with a duty to report security-based swaps under Regulation SBSR would be required to report all newly executed security-based swaps in that asset class to a registered SDR. After Compliance Date 1, persons with a duty to report security-based swaps also would have a duty to report any life cycle events of any security-based swaps that previously had been required to be reported. In addition, persons with a duty to report pre-enactment and transitional security-based swaps [5] in the relevant asset class would be required to report these transactions by the Compliance Date rather than on the Compliance Date.
- Proposed Compliance Date 2: Within nine months after the first registered SDR that accepts security-based swaps in a particular asset class commences operations as a registered SDR (three months after Compliance Date 1), each registered SDR in that asset class that has registered and commenced operation would be required generally to comply with the public dissemination requirement for all security-based swaps in that asset class.

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endnotes

[1] Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, Release No. 34-74245 (Feb. 11, 2015), available at http://www.sec.gov/rules/proposed/2015/34-74245.pdf ("Proposed Rules").

[2] Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, Release No. 34-74244 (Feb. 11, 2015) available at http://www.sec.gov/rules/final/2015/34-74246.pdf ("Regulation SBSR Adopting Release"). Regulation SBSR assigns the duty to report covered transactions, which include all security-based swaps except: (1) clearing transactions; (2) security-based swaps that are executed on a platform and that will be submitted to clearing; (3) transactions where there is no US person, registered security-based swap dealer, or registered major security-based swap participant on either side; and (4) transactions where there is no registered security-based swap dealer or registered majority security-based swap participant on either side and there is a US person only on one side. The Proposed Rules would assign the duty to report security-based swaps in categories (1) and (2). The SEC anticipates seeking additional comment in the future on the reporting obligations for security-based swaps in categories (3) and (4).

[3] A "clearing transaction" is defined as a "security-based swap that has a registered clearing agency as a direct counterparty." See Rule 900(g) of Regulation SBSR.

[4] Under Regulation SBSR, if the counterparties are not yet known (i.e., the clients of the asset manager), the requirement to report the execution agent ID instead of the counterparty ID would apply. The SEC also states that if the asset manager uses an execution agent to access the platform, the platform would report the identity of the asset manager's execution agent. According to Commissioner Gallaher, the rule is "trying to capture entities that could act as agents in a security-based swap transaction, such as an asset manager acting as an agent on behalf of a fund counterparty." Commissioner Daniel M. Gallagher, Dissenting Statement Regarding Adoption of Regulation SDR (Jan. 13, 2015), available at http://www.sec.gov/news/statement/dissent-adoption-of-regulation-sdr-commissioner-gallagher.html#.VOZNOyhnCg0.

[5] Pre-enactment security-based swaps are security-based swaps entered into before the date of enactment of the Dodd-Frank Act, and transitional security-based swaps are security-based swaps entered into after the date of enactment but before Rule 901 of Regulation SBSR becomes fully operative.