**6351-01-P**

**COMMODITY FUTURES TRADING COMMISSION**

**Comparability Determination for the European Union: Certain Transaction-Level Requirements**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of Comparability Determination for Certain Requirements under the European Market Infrastructure Regulation.

**SUMMARY:** The following is the analysis and determination of the Commodity Futures Trading Commission ("Commission") regarding certain parts of a joint request by the European Commission ("EC") and the European Securities and Markets Authority ("ESMA") that the Commission determine that laws and regulations applicable in the European Union ("EU") provide a sufficient basis for an affirmative finding of comparability with respect to the following regulatory obligations applicable to swap dealers ("SDs") and major swap participants ("MSPs") registered with the Commission: (i) swap trading relationship documentation; (ii) swap portfolio reconciliation and compression; (iii) trade confirmation; and (iv) daily trading records (collectively, the "Business Conduct Requirements").

**EFFECTIVE DATE:** This determination will become effective immediately upon publication in the Federal Register.

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**SUPPLEMENTARY INFORMATION:**

## I. Introduction

On July 26, 2013, the Commission published in the Federal Register its "Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations" ("Guidance").[1] In the Guidance, the Commission set forth its interpretation of the manner in which it believes that section 2(i) of the Commodity Exchange Act ("CEA") applies Title VII's swap provisions to activities outside the U.S. and informed the public of some of the policies that it expects to follow, generally speaking, in applying Title VII and certain Commission regulations in contexts covered by section 2(i). Among other matters, the Guidance generally described the policy and procedural framework under which the Commission would consider a substituted compliance program with respect to Commission regulations applicable to entities located outside the U.S. Specifically, the Commission addressed a recognition program where compliance with a comparable regulatory requirement of a foreign jurisdiction would serve as a reasonable substitute for compliance with the attendant requirements of the CEA and the Commission's regulations promulgated thereunder.

In addition to the Guidance, on July 22, 2013, the Commission issued the Exemptive Order Regarding Compliance with Certain Swap Regulations (the "Exemptive

[1] 78 FR 45292 (July 26, 2013). The Commission originally published proposed and further proposed guidance on July 12, 2012 and January 7, 2013, respectively. See Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 FR 41214 (July 12, 2012) and Further Proposed Guidance Regarding Compliance with Certain Swap Regulations,78 FR 909 (Jan. 7, 2013).

Order").[2] Among other things, the Exemptive Order provided time for the Commission to consider substituted compliance with respect to six jurisdictions where non-U.S. SDs are currently organized. In this regard, the Exemptive Order generally provided non-U.S. SDs and MSPs (and foreign branches of U.S. SDs and MSPs) in the six jurisdictions with conditional relief from certain requirements of Commission regulations (those referred to as "Transaction-Level Requirements" in the Guidance) until the earlier of December 21, 2013, or 30 days following the issuance of a substituted compliance determination.[3] However, the Commission provided only transitional relief from the real-time public reporting requirements under part 43 of the Commission's regulations until September 30, 2013, stating that "it would not be in the public interest to further delay reporting under part 43 . . . ."[4] Similarly, the Commission provided transitional relief only until October 10, 2013, from the clearing and swap processing requirements (as described in the Guidance), stating that, "[b]ecause SDs and MSPs have been committed to clearing their [credit default swaps] and interest rate swaps for many years, and indeed have been voluntarily clearing for many years, any further delay of the Commission's clearing requirement is unwarranted."[5] The Commission did not make any comparability determination with respect to clearing and swap processing prior to October 10, 2013, or real-time public reporting prior to September 30, 2013.

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[2] 78 FR 43785 (July 22, 2013).

[3] The Transaction-Level Requirements under the Exemptive Order consist of 17 CFR 37.12, 38.11, 23.202, 23.205, 23.400-451, 23.501, 23.502, 23.503, 23.504, 23.505, 23.506, 23.610, and parts 43 and 50 of the Commission's regulations.

[4] See id. at 43789.

[5] See id. at 43790.

On May 7, 2013, the EC and ESMA (collectively, the "applicant") submitted a request that the Commission determine that laws and regulations applicable in the EU provide a sufficient basis for an affirmative finding of comparability with respect to certain Transaction-Level Requirements, including the Business Conduct Requirements.[6] The applicant provided Commission staff with an updated submission on August 6, 2013. On November 11, 2013, the application was further supplemented with corrections and additional materials. The following is the Commission's analysis and determination regarding the Business Conduct Requirements, as detailed below.

In addition to the Business Conduct Requirements described below, the applicant also requested a comparability determination with respect to law and regulations applicable in the EU governing (1) clearing and swap processing;[7] and (2) real-time public reporting. The Commission declines to take up the request for such comparability determination at this time due to the Commission's view that there are not laws or regulations applicable in the EU to compare with the requirements of the Commission's regulations on mandatory clearing and swap processing, and real-time public reporting.

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[6] For purposes of this notice, the Business Conduct Requirements consist of 17 CFR 23.202, 23.501, 23.502, 23.503, and 23.504.

[7] According to the most recent Financial Stability Board Progress Report, the EU is scheduled to have a clearing requirement by Q3 2014. That report also states that the EU is scheduled to begin authorizing CCPs in Q4 2013, issue its first clearing determinations in Q1 2014, and adopt central clearing Regulatory Technical Standards (RTS) in Q2 2014 (OTC Derivatives Working Group, "OTC Derivatives Market Reforms: Sixth Progress Report on Implementation," Financial Stability Board, Sept. 2, 2013). Under EMIR, ESMA would determine which swaps would be subject to mandatory clearing according to provisions that are comparable to those set forth in Commission regulation 39.5(b). A clearing requirement would apply to financial entities, as well as to non-financial entities whose swap activity exceeds a certain threshold. ESMA's "Discussion Paper, The Clearing Obligation under EMIR" (July 2013) describes the standardized swaps that could be subject to a clearing requirement. Such swaps include the interest rate and credit default swaps covered by the Commission's clearing requirement (Commission regulation 50.4), other credit default swap indices, non-deliverable forwards that may be included in a Commission clearing requirement, and many other swaps including OTC equity index derivatives cleared only through European central counterparties, some of which are not Commission-registered derivatives clearing organizations.

The Commission may address these requests in a separate notice at a later date in consequence of further developments in the law and regulations applicable in the EU.

## II. Background

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act[8] ("Dodd-Frank Act" or "Dodd-Frank"), which, in Title VII, established a new regulatory framework for swaps.

Section 722(d) of the Dodd-Frank Act amended the CEA by adding section 2(i), which provides that the swap provisions of the CEA (including any CEA rules or regulations) apply to cross-border activities when certain conditions are met, namely, when such activities have a "direct and significant connection with activities in, or effect on, commerce of the United States" or when they contravene Commission rules or regulations as are necessary or appropriate to prevent evasion of the swap provisions of the CEA enacted under Title VII of the Dodd-Frank Act.[9]

In the three years since its enactment, the Commission has finalized 68 rules and orders to implement Title VII of the Dodd-Frank Act. The finalized rules include those promulgated under section 4s of the CEA, which address registration of SDs and MSPs and other substantive requirements applicable to SDs and MSPs. With few exceptions, the delayed compliance dates for the Commission's regulations implementing such section 4s requirements applicable to SDs and MSPs have passed and new SDs and MSPs are now required to be in full compliance with such regulations upon registration with the

[8] Public Law 111-203, 124 Stat. 1376 (2016).

[9] 7 U.S.C. § 2(i).

Commission.[10] Notably, the requirements under Title VII of the Dodd-Frank Act related to SDs and MSPs by their terms apply to all registered SDs and MSPs, irrespective of where they are located, albeit subject to the limitations of CEA section 2(i).

To provide guidance as to the Commission's views regarding the scope of the cross-border application of Title VII of the Dodd-Frank Act, the Commission set forth in the Guidance its interpretation of the manner in which it believes that Title VII's swap provisions apply to activities outside the U.S. pursuant to section 2(i) of the CEA. Among other matters, the Guidance generally describes the policy and procedural framework under which the Commission would consider a substituted compliance program with respect to Commission regulations applicable to entities located outside the U.S. Specifically, the Commission established a recognition program where compliance with a comparable regulatory requirement of a foreign jurisdiction would serve as a reasonable substitute for compliance with the attendant requirements of the CEA and the Commission's regulations. With respect to the standards forming the basis for any determination of comparability ("comparability determination" or "comparability finding"), the Commission stated:

> In evaluating whether a particular category of foreign regulatory requirement(s) is comparable and comprehensive to the applicable requirement(s) under the CEA and Commission regulations, the Commission will take into consideration all relevant factors, including but not limited to, the comprehensiveness of those requirement(s), the scope and objectives of the relevant regulatory requirement(s), the comprehensiveness of the foreign regulator's supervisory compliance program, as well as the home jurisdiction's authority to support and enforce its oversight of the registrant. In this context, comparable does not necessarily mean identical. Rather, the Commission would evaluate

[10] The compliance dates are summarized on the Compliance Dates page of the Commission's Web site. (http://www.cftc.gov/LawRegulation/DoddFrankAct/ComplianceDates/index.htm.)

> whether the home jurisdiction's regulatory requirement is comparable to and as comprehensive as the corresponding U.S. regulatory requirement(s).[11]

Upon a comparability finding, consistent with CEA section 2(i) and comity principles, the Commission's policy generally is that eligible entities may comply with a substituted compliance regime subject to any conditions the Commission places on its finding, and subject to the Commission's retention of its examination authority and its enforcement authority.[12]

In this regard, the Commission notes that a comparability determination cannot be premised on whether an SD or MSP must disclose comprehensive information to its regulator in its home jurisdiction, but rather on whether information relevant to the Commission's oversight of an SD or MSP would be directly available to the Commission and any U.S. prudential regulator of the SD or MSP.[13] The Commission's direct access to the books and records required to be maintained by an SD or MSP registered with the

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[11] 78 FR at 45342-45345.

[12] See the Guidance, 78 FR at 45342-44.

[13] Under §§ 23.203 and 23.606, all records required by the CEA and the Commission's regulations to be maintained by a registered SD or MSP shall be maintained in accordance with Commission regulation 1.31 and shall be open for inspection by representatives of the Commission, the United States Department of Justice, or any applicable prudential regulator.

In its Final Exemptive Order Regarding Compliance with Certain Swap Regulations, 78 FR 858 (Jan. 7, 2013), the Commission noted that an applicant for registration as an SD or MSP must file a Form 7-R with the National Futures Association and that Form 7-R was being modified at that time to address existing blocking, privacy, or secrecy laws of foreign jurisdictions that applied to the books and records of SDs and MSPs acting in those jurisdictions. See id. at 871-72 n. 107. The modifications to Form 7-R were a temporary measure intended to allow SDs and MSPs to apply for registration in a timely manner in recognition of the existence of the blocking, privacy, and secrecy laws. In the Guidance, the Commission clarified that the change to Form 7-R impacts the registration application only and does not modify the Commission's authority under the CEA and its regulations to access records held by registered SDs and MSPs. Commission access to a registrant's books and records is a fundamental regulatory tool necessary to properly monitor and examine each registrant's compliance with the CEA and the regulations adopted pursuant thereto. The Commission has maintained an ongoing dialogue on a bilateral and multilateral basis with foreign regulators and with registrants to address books and records access issues and may consider appropriate measures where requested to do so.

Commission is a core requirement of the CEA[14] and the Commission's regulations,[15] and is a condition to registration.[16]

## III. Regulation of SDs and MSPs in the EU

On May 7, 2013, the EC and ESMA submitted a request that the Commission assess the comparability of laws and regulations applicable in the EU with the requirements of the CEA and the Commission's regulations, and that a determination be made on the extent to which SDs and MSPs in the EU can rely on substituted compliance.[17] The applicant provided Commission staff with an updated submission on August 6, 2013. On November 11, 2013, the application was further supplemented with corrections and additional materials.

[14] See e.g., sections 4s(f)(1)(C), 4s(j)(3) and (4) of the CEA.

[15] See e.g., §§ 23.203(b) and 23.606.

[16] See supra note 13.

[17] On July 11, 2013, the Commission staff issued a no-action letter related to EU rules on risk mitigation. See No-Action Relief for Registered Swap Dealers and Major Swap Participants from Certain Requirements under Subpart I of Part 23 of Commission Regulations in Connection with Uncleared Swaps Subject to Risk Mitigation Techniques under EMIR, CFTC Letter No. 13-45 (July, 11, 2013) ("Risk Mitigation Letter"). The Commission staff found that the Commission and the EU have essentially identical rules in important areas of risk mitigation for the largest counterparty swap market participants. Specifically, the Commission staff determined that under EMIR, the EU has adopted risk mitigation rules that are essentially identical to certain provisions of the Commission's business conduct standards for SDs and MSPs. In areas such as confirmation, portfolio reconciliation, portfolio compression, valuation, and dispute resolution, the Commission staff found that the respective regimes are essentially identical. The Commission staff determined that where a swap/OTC derivative is subject to concurrent jurisdiction under US and EU risk mitigation rules, compliance under EMIR will achieve compliance with the relevant Commission rules because they are essentially identical. The Commission's analysis of the subject submission is informed by the staff's finding in connection with the Risk Mitigation Letter but the Commission notes that the standards applied in that context are distinguishable from the "comparable and comprehensive" standards applied in the instant comparability determination.

As represented to the Commission by the applicant, swap activities in the EU member states is governed primarily by the European Market Infrastructure Regulation ("EMIR").[18]

EMIR and the Regulatory Technical Standards ("RTS") are regulations with immediate, binding, and direct effect in all EU member states (i.e., no transposition into domestic law is required). EMIR entered into force on August 16, 2012.

Commission Delegated Regulation (EU) No 149/2013 of December 19, 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a central counterparty ("CCP") ("OTC RTS") entered into force on March 15, 2013.

It is helpful to note certain terminology used in EMIR:

- Financial counterparties ("FCs"), Article 2(8) EMIR: all types of counterparties established in the EU - regardless of size or activity - that are financial in nature and authorized as such: credit institutions, insurers/reinsurers, pension funds, and hedge funds.

- Non-financial counterparties ("NFCs"), Article 2(9) EMIR: all types of counterparties established in the EU that do not meet the definition of an FC (e.g., corporates, certain SPVs).

[18] EMIR: Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF

- Non-financial counterparties above the clearing threshold ("NFCs+"), Non-financial counterparties below the clearing threshold ("NFCs-"):

- The clearing thresholds are calculated at the group level and are as follows:

(a) EUR 1 billion in gross notional value for OTC credit derivative contracts;

(b) EUR 1 billion in gross notional value for OTC equity derivative contracts;

(c) EUR 3 billion in gross notional value for OTC interest rate derivative contracts;

(d) EUR 3 billion in gross notional value for OTC foreign exchange derivative contracts; and

(e) EUR 3 billion in gross notional value for OTC commodity derivative contracts and other OTC derivative contracts not provided for under points (a) to (d).

However, transactions objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity of the NFC or its group (i.e., hedges) do not count towards the clearing threshold.[19] Under the hedging definition both portfolio and macro hedging are allowed.

Certain requirements of EMIR and the RTS are subject to delayed implementation. EMIR Article 11 and RTS Articles 12 to 17 are subject to a phase-in period:

- Timely Confirmation: Staggered phase-in according to product type.

- Portfolio Reconciliation, Compression, and Dispute Resolution: Requirements operational for all market participants subject to them (different provisions apply to FC, NFC+ and NFC-) as of September 15, 2013.

[19] See EMIR Article 10 and RTS Article 10.

- Daily mark-to-market and mark-to-model: Applies to FC and NFC+ as of March 15, 2013.

In addition, as represented to the Commission by the applicant, swap activities in the EU are also governed by a number of regulatory requirements other than EMIR.

Markets in Financial Instruments Directive ("MiFID)":[20] MiFID is a directive and in accordance with the Treaty on the Functioning of the European Union, all member states of the EU are legally bound to implement the provisions of MiFID by November 1, 2007, by transposing them into their national laws. MiFID applies in particular to investment firms, which comprise any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis. Investment services and activities means any of the services and activities listed in Section A of Annex I of MiFID relating to any of the instruments listed in Section C of Annex I of MiFID. Section C of Annex 1 refers explicitly to swaps as well as "other derivative financial instruments."

Due to the requirement that each EU member state transpose MiFID into its national law, the comparability determinations in this notice are based on the representations of the applicant to the Commission that (i) each member state of the EU where an SD or MSP would seek to rely on substituted compliance on the basis of the comparability of the MiFID standards has completed the process of transposing MiFID

[20] Directive 2004/39/EC and the relevant implementing measures (Directive 2006/73/EC and Regulation 1287/2006). http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32004L0039:EN:NOT

into its national law;[21] (ii) such national laws have transposed MiFID without change in any aspect that is material for a comparability determination contained herein; and (iii) such transposed law is in full force and effect as of the time that any SD or MSP seeks to rely on a relevant comparability determination contained herein. The Commission notes that to the extent that any of the foregoing representations are incorrect, an affected comparability determination will not be valid.[22]

In addition to MiFID, the applicant noted that there are a number of proposed laws and regulations that, when implemented, would affect the regulation of SDs and MSPs in the EU.[23]

## IV. Comparable and Comprehensiveness Standard

The Commission's comparability analysis will be based on a comparison of specific foreign requirements against the specific related CEA provisions and Commission regulations as categorized and described in the Guidance. As explained in

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[21] See the website of the European Commission for confirmation of the transposition of MiFID into the national law of each member state, available here: http://ec.europa.eu/internal_market/securities/docs/transposition/table_en.pdf. Note that the issue of partial implementation in the Netherlands was resolved in 2008, http://ec.europa.eu/eu_law/eulaw/decisions/dec_08_05_06.htm. The Commission notes that the EC has certified to the Commission that each member state in which a registered SD or MSP is organized has completed the transposition process (e.g., Ireland, UK, France, Spain, and Germany).

[22] Because the applicant's request and the Commission's determinations herein are based on the comparability of EU requirements applicable to entities subject to EMIR and MiFID, an SD or MSP that is not subject to the requirements of EMIR or MiFID upon which the Commission bases its determinations, may not be able to rely on the Commission's comparability determinations herein. The applicant has noted for the Commission that the concept of an MSP is not explicitly mirrored in EU legislation and so it cannot be confirmed that MSPs would always be covered by EMIR and MiFID. However, the applicant states that the definition of an "investment firm" under MiFID is considerably wider than that of an SD, and thus MSP's should, in most cases, be caught within the definition of "investment firm."

[23] The applicant provided information regarding MiFID II and the Markets in Financial Instruments Regulation ("MiFIR"), http://ec.europa.eu/internal_market/securities/isd/mifid/index_en.htm, stating that these two proposals are part of the legislative package for the review of MiFID, and that the legislative process may be concluded with the adoption of the final political agreement by the end of 2013. The applicant further stated that an additional 18 to 24 months will be needed to adopt implementing measures, with the overall package to be applied by the end of 2015.

the Guidance, within the framework of CEA section 2(i) and principles of international comity, the Commission may make a comparability determination on a requirement-by-requirement basis, rather than on the basis of the foreign regime as a whole.[24] In making its comparability determinations, the Commission may include conditions that take into account timing and other issues related to coordinating the implementation of reform efforts across jurisdictions.[25]

In evaluating whether a particular category of foreign regulatory requirement(s) is comparable and comprehensive to the corollary requirement(s) under the CEA and Commission regulations, the Commission will take into consideration all relevant factors, including, but not limited to:

- The comprehensiveness of those requirement(s),
- The scope and objectives of the relevant regulatory requirement(s),
- The comprehensiveness of the foreign regulator's supervisory compliance program, and
- The home jurisdiction's authority to support and enforce its oversight of the registrant.[26]

In making a comparability determination, the Commission takes an "outcome-based" approach. An "outcome-based" approach means that when evaluating whether a foreign jurisdiction's regulatory requirements are comparable to, and as comprehensive as, the corollary areas of the CEA and Commission regulations, the Commission

[24] 78 FR at 45343.

[25] 78 FR at 45343.

[26] 78 FR at 45343.

ultimately focuses on regulatory outcomes (i.e., the home jurisdiction's requirements do not have to be identical).[27] This approach recognizes that foreign regulatory systems differ and their approaches vary and may differ from how the Commission chose to address an issue, but that the foreign jurisdiction's regulatory requirements nonetheless achieve the regulatory outcome sought to be achieved by a certain provision of the CEA or Commission regulation.

In doing its comparability analysis, the Commission may determine that no comparability determination can be made[28] and that the non-U.S. SD or non-U.S. MSP, U.S. bank that is an SD or MSP with respect to its foreign branches, or non-registrant, to the extent applicable under the Guidance, may be required to comply with the CEA and Commission regulations.

The starting point in the Commission's analysis is a consideration of the regulatory objectives of the foreign jurisdiction's regulation of swaps and swap market participants. As stated in the Guidance, jurisdictions may not have swap specific regulations in some areas, and instead have regulatory or supervisory regimes that achieve comparable and comprehensive regulation to the Dodd-Frank Act requirements, but on a more general, entity-wide, or prudential, basis.[29] In addition, portions of a

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[27] 78 FR at 45343. The Commission's substituted compliance program would generally be available for swap data repository reporting ("SDR Reporting"), as outlined in the Guidance, only if the Commission has direct access to all of the data elements that are reported to a foreign trade repository pursuant to the substituted compliance program. Thus, direct access to swap data is a threshold matter to be addressed in a comparability evaluation for SDR Reporting. Moreover, the Commission explains in the Guidance that, due to its technical nature, a comparability evaluation for SDR Reporting "will generally entail a detailed comparison and technical analysis." A more particularized analysis will generally be necessary to determine whether data stored in a foreign trade repository provides for effective Commission use, in furtherance of the regulatory purposes of the Dodd-Frank Act. See 78 FR at 45345.

[28] A finding of comparability may not be possible for a number of reasons, including the fact that the foreign jurisdiction has not yet implemented or finalized particular requirements.

[29] 78 FR at 45343.

foreign regulatory regime may have similar regulatory objectives, but the means by which these objectives are achieved with respect to swap market activities may not be clearly defined, or may not expressly include specific regulatory elements that the Commission concludes are critical to achieving the regulatory objectives or outcomes required under the CEA and the Commission's regulations. In these circumstances, the Commission will work with the regulators and registrants in these jurisdictions to consider alternative approaches that may result in a determination that substituted compliance applies.[30]

Finally, the Commission generally will rely on an applicant's description of the laws and regulations of the foreign jurisdiction in making its comparability determination. The Commission considers an application to be a representation by the applicant that the laws and regulations submitted are in full force and effect, that the description of such laws and regulations is accurate and complete, and that, unless otherwise noted, the scope of such laws and regulations encompasses the swaps

[30] As explained in the Guidance, such "approaches used will vary depending on the circumstances relevant to each jurisdiction. One example would include coordinating with the foreign regulators in developing appropriate regulatory changes or new regulations, particularly where changes or new regulations already are being considered or proposed by the foreign regulators or legislative bodies. As another example, the Commission may, after consultation with the appropriate regulators and market participants, include in its substituted compliance determination a description of the means by which certain swaps market participants can achieve substituted compliance within the construct of the foreign regulatory regime. The identification of the means by which substituted compliance is achieved would be designed to address the regulatory objectives and outcomes of the relevant Dodd-Frank Act requirements in a manner that does not conflict with a foreign regulatory regime and reduces the likelihood of inconsistent regulatory obligations. For example, the Commission may specify that [SDs] and MSPs in the jurisdiction undertake certain recordkeeping and documentation for swap activities that otherwise is only addressed by the foreign regulatory regime with respect to financial activities generally. In addition, the substituted compliance determination may include provisions for summary compliance and risk reporting to the Commission to allow the Commission to monitor whether the regulatory outcomes are being achieved. By using these approaches, in the interest of comity, the Commission would seek to achieve its regulatory objectives with respect to the Commission's registrants that are operating in foreign jurisdictions in a manner that works in harmony with the regulatory interests of those jurisdictions." 78 FR at 45343-44.

activities[31] of SDs and MSPs[32] in the relevant jurisdictions. [33] Further, as stated in the Guidance, the Commission expects that an applicant would notify the Commission of any material changes to information submitted in support of a comparability determination (including, but not limited to, changes in the relevant supervisory or regulatory regime) as, depending on the nature of the change, the Commission's comparability determination may no longer be valid.[34]

The Guidance provided a detailed discussion of the Commission's policy regarding the availability of substituted compliance[35] for the Business Conduct Requirements.

## V. Supervisory Arrangement

In the Guidance, the Commission stated that, in connection with a determination that substituted compliance is appropriate, it would expect to enter into an appropriate

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[31] "Swaps activities" is defined in Commission regulation 23.600(a)(7) to mean, "with respect to a registrant, such registrant's activities related to swaps and any product used to hedge such swaps, including, but not limited to, futures, options, other swaps or security-based swaps, debt or equity securities, foreign currency, physical commodities, and other derivatives." The Commission's regulations under Part 23 (17 CFR Part 23) are limited in scope to the swaps activities of SDs and MSPs.

[32] No SD or MSP that is not legally required to comply with a law or regulation determined to be comparable may voluntarily comply with such law or regulation in lieu of compliance with the CEA and the relevant Commission regulation. Each SD or MSP that seeks to rely on a comparability determination is solely responsible for determining whether it is legally required to comply with the laws and regulations found comparable. Currently, there are no MSPs organized outside the U.S. and the Commission therefore cautions any non-financial entity organized outside the U.S. and applying for registration as an MSP to carefully consider whether the laws and regulations determined to be comparable herein are applicable to such entity.

[33] The Commission has provided the relevant foreign regulator(s) with opportunities to review and correct the applicant's description of such laws and regulations on which the Commission will base its comparability determination. The Commission relies on the accuracy and completeness of such review and any corrections received in making its comparability determinations. A comparability determination based on an inaccurate description of foreign laws and regulations may not be valid.

[34] 78 FR at 45345.

[35] See 78 FR at 45348-50. The Commission notes that registrants and other market participants are responsible for determining whether substituted compliance is available pursuant to the Guidance based on the comparability determination contained herein (including any conditions or exceptions), and its particular status and circumstances.

memorandum of understanding ("MOU") or similar arrangement[36] with the relevant foreign regulator(s). Although existing arrangements would indicate a foreign regulator's ability to cooperate and share information, "going forward, the Commission and relevant foreign supervisor(s) would need to establish supervisory MOUs or other arrangements that provide for information sharing and cooperation in the context of supervising [SDs] and MSPs."[37]

The Commission is in the process of developing its registration and supervision regime for provisionally-registered SDs and MSPs. This new initiative includes setting forth supervisory arrangements with authorities that have joint jurisdiction over SDs and MSPs that are registered with the Commission and subject to U.S. law. Given the developing nature of the Commission's regime and the fact that the Commission has not negotiated prior supervisory arrangements with certain authorities, the negotiation of supervisory arrangements presents a unique opportunity to develop close working relationships between and among authorities, as well as highlight any potential issues related to cooperation and information sharing.

Accordingly, the Commission is negotiating such a supervisory arrangement with each applicable foreign regulator of an SD or MSP. The Commission expects that the arrangement will establish expectations for ongoing cooperation, address direct access to information,[38] provide for notification upon the occurrence of specified events,

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[36] An MOU is one type of arrangement between or among regulators. Supervisory arrangements could include, as appropriate, cooperative arrangements that are memorialized and executed as addenda to existing MOUs or, for example, as independent bilateral arrangements, statements of intent, declarations, or letters.

[37] 78 FR at 45344.

[38] Section 4s(j)(3) and (4) of the CEA and Commission regulation 23.606 require a registered SD or MSP to make all records required to be maintained in accordance with Commission regulation 1.31 available

memorialize understandings related to on-site visits,[39] and include protections related to the use and confidentiality of non-public information shared pursuant to the arrangement.

These arrangements will establish a roadmap for how authorities will consult, cooperate, and share information. As with any such arrangement, however, nothing in these arrangements will supersede domestic laws or resolve potential conflicts of law, such as the application of domestic secrecy or blocking laws to regulated entities.

## VI. Comparability Determination and Analysis

The following section describes the requirements imposed by specific sections of the CEA and the Commission's regulations for the Business Conduct Requirements in the "risk mitigation and transparency" category that are the subject of this comparability determination and the Commission's regulatory objectives with respect to such requirements. Immediately following a description of the requirement(s) and regulatory objective(s) of the specific Business Conduct Requirements that the requestor submitted for a comparability determination, the Commission provides a description of the foreign jurisdiction's comparable laws, regulations, or rules and whether such laws, regulations, or rules meet the applicable regulatory objective.

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promptly upon request to, among others, representatives of the Commission. See also 7 U.S.C. § 6s(f); 17 CFR 23.203. In the Guidance, the Commission states that it "reserves this right to access records held by registered [SDs] and MSPs, including those that are non-U.S. persons who may comply with the Dodd-Frank recordkeeping requirement through substituted compliance." 78 FR at 45345 n. 472; see also id. at 45342 n. 461 (affirming the Commission's authority under the CEA and its regulations to access books and records held by registered SDs and MSPs as "a fundamental regulatory tool necessary to properly monitor and examine each registrant's compliance with the CEA and the regulations adopted pursuant thereto").

[39] The Commission retains its examination authority, both during the application process as well as upon and after registration of an SD or MSP. See 78 FR at 45342 (stating Commission policy that "eligible entities may comply with a substituted compliance regime under certain circumstances, subject, however, to the Commission's retention of its examination authority") and 45344 n. 471 (stating that the "Commission may, as it deems appropriate and necessary, conduct an on-site examination of the applicant").

The Commission's determinations in this regard and the discussion in this section are intended to inform the public of the Commission's views regarding whether the foreign jurisdiction's laws, regulations, or rules may be comparable to and as comprehensive as those requirements in the Dodd-Frank Act (and Commission regulations promulgated thereunder) and therefore, may form the basis of substituted compliance. In turn, the public (in the foreign jurisdiction, in the United States, and elsewhere) retains its ability to present facts and circumstances that would inform the determinations set forth in this release.

As was stated in the Guidance, the Commission understands the complex and dynamic nature of the global swap market and the need to take an adaptable approach to cross-border issues, particularly as it continues to work closely with foreign regulators to address potential conflicts with respect to each country's respective regulatory regime. In this regard, the Commission may review, modify, or expand the determinations herein in light of comments received and future developments.

### A. Portfolio Reconciliation and Compression

CEA section 4s(i) directs the Commission to prescribe regulations for the timely and accurate processing and netting of all swaps entered into by SDs and MSPs. Accordingly, pursuant to CEA section 4s(i), the Commission adopted §§ 23.502 and 23.503, which require SDs and MSPs to perform portfolio reconciliation and compression, respectively, for all swaps.[40]

[40] 7 U.S.C. § 6s(i).

1. Portfolio Reconciliation (§ 23.502)

**Commission Requirement**: Regulation 23.502 provides standards for the timely and accurate confirmation, processing, and valuation of uncleared swaps by SDs and MSPs. The regulation requires SDs and MSPs to engage in portfolio reconciliation,[41] which is a post-execution processing and risk management technique that is designed to: (i) identify and resolve discrepancies between the counterparties with regard to the terms of a swap after execution and during the life of the swap; and (ii) identify and resolve discrepancies between the counterparties regarding the valuation of the swap.

Pursuant to Commission regulation 23.502, for swap portfolios with other SDs/MSPs, an SD/MSP must agree in writing on the terms of reconciling the terms and valuations of each uncleared swap in the portfolio (which may be performed bilaterally or by a qualified third party), and must perform the reconciliation no less frequently than:

- Each business day for portfolios of 500 or more swaps;
- Once each week for portfolios of more than 50 but fewer than 500 swaps; and
- Quarterly for portfolios of no more than 50 swaps.

Discrepancies in material terms must be resolved immediately; and SDs and MSPs must have policies and procedures to resolve discrepancies of 10% or greater in valuations as soon as possible but no later than five business days, provided that the SD

[41] The term "portfolio reconciliation" is defined in § 23.500(i) as any process by which the two parties to one or more swaps: (1) exchange the terms of all swaps in the swap portfolio between the counterparties; (2) exchange each counterparty's valuation of each swap in the swap portfolio between the counterparties as of the close of business on the immediately preceding business day; and (3) resolve any discrepancy in material terms and valuations.

or MSP has policies and procedures for identifying how it will comply with variation margin requirements pending resolution of a valuation dispute.

For swap portfolios with non-SDs/MSPs, an SD/MSP must establish policies and procedures for engaging in portfolio reconciliation that include:

- Agreement in writing on the terms for reconciling the terms and valuations of each uncleared swap in the portfolio (which may be performed bilaterally or by a qualified third party);
- Portfolio reconciliation frequencies of quarterly for portfolios of more than 100 swaps, and annually for portfolios of 100 or fewer swaps; and
- Discrepancies in material terms and valuations of more than 10% must be subject to procedures for resolving such discrepancies in a timely fashion.

An SD/MSP must report any valuation dispute exceeding $20,000,000 to the Commission and any applicable prudential regulator if not resolved within three business days (with respect to disputes between SDs/MSPs) or five business days (with any other counterparty).

**Regulatory Objective:** The Commission's portfolio reconciliation rule is designed to ensure accurate confirmation of a swap's terms and to identify and resolve any discrepancies between counterparties regarding the valuation of the swap. Given that arriving at a daily valuation is one of the building blocks for the margin regulations and is essential for the mitigation of risk posed by swaps, the regulations are aimed at ensuring that valuation disputes are resolved in a timely manner. Disputes related to confirming the terms of a swap, as well as swap valuation disputes impacting margin payments, have long been recognized as a significant problem in the OTC derivatives market, and

portfolio reconciliation is widely recognized as an effective means of identifying and resolving these disputes. By identifying and managing mismatches in key economic terms and valuation for individual transactions across an entire portfolio, the regulations are aimed at achieving a process in which overall risk can be identified and reduced. The frequency of reconciliation of material terms and valuations of each swap required by the regulations will ensure the risk-reducing benefits of reconciliation by presenting a consolidated view of counterparty exposure down to the transaction level. The frequency with which portfolio reconciliation must be performed is a key component of this regulation.

**Comparable EU Law and Regulations:** The applicant has represented to the Commission that the following provisions of law and regulations applicable in the EU are in full force and effect in the EU, and comparable to and as comprehensive as section 4s(i) of the CEA and Commission regulation 23.502.

- OTC RTS Art. 13.1: FCs and NFCs must agree with each of their counterparties in writing or other equivalent electronic means on the terms on which portfolios of uncleared OTC derivative contracts shall be reconciled. Such agreement must be reached before entering into the OTC derivative contract.

- OTC RTS Art. 13.2: Portfolio reconciliation must be performed by the counterparties to the OTC derivative contracts with each other, or by a qualified third party duly mandated to this effect by a counterparty.

- The portfolio reconciliation must cover key trade terms that identify each particular OTC derivative contract and must include <u>at least</u> the valuation attributed to each contract in accordance with the mark-to-market/mark-to-model obligation.

- In order to identify at an early stage any discrepancy in a material term of the OTC derivative contract, including its valuation, the portfolio reconciliation must be performed within the following timeframes. For portfolios between or among FCs or NFCs+, each business day when the counterparties have 500 or more OTC derivative contracts outstanding with each other; once per week when the counterparties have between 51 and 499 OTC derivative contracts outstanding with each other at any time during the week; and once per quarter when the counterparties have 50 or less OTC derivative contracts outstanding with each other at any time during the quarter. For portfolios where at least one of the counterparties is an NFC-, once per quarter when the counterparties have more than 100 OTC derivative contracts outstanding with each other at any time during the quarter; and once per year when the counterparties have 100 or less OTC derivative contracts outstanding with each other.

**Commission Determination:** Pursuant to the foregoing standards under EMIR, FCs and NFCs must agree in writing with each of their OTC derivatives counterparties on the terms on which portfolios will be reconciled,[42] which corresponds to the requirement in Commission regulation 23.502(a) and (b) that SDs and MSPs agree in writing with each counterparty (financial and non-financial) on the terms for conducting portfolio reconciliation.

The EMIR standards require portfolio reconciliation covering key trade terms of each OTC derivative contract, including at least the valuation of each contract,[43] which

[42] See Article 13 of the EMIR Regulatory Technical Standards. In addition, Article 13(2) permits the reconciliation to be performed by a third-party, which corresponds to Commission regulation 23.502(a)(2) and (b)(2).

[43] See Article 13(2) of the EMIR Regulatory Technical Standards.

corresponds to the requirements under Commission regulation 23.502 that discrepancies in material terms and valuations be resolved.

Frequency of reconciliation required under the EMIR standards for FCs and NFCs+ is daily when the number of outstanding OTC derivative contracts between counterparties is 500 or more, weekly when the number of outstanding OTC derivative contracts between counterparties is greater than 50 and less than 500, and quarterly when the number of OTC derivative contracts between counterparties is 50 or less,[44] which corresponds with the frequency required of SDs and MSPs outlined above with respect to portfolios with other SDs and MSPs. EMIR requires reconciliation with NFCs- less frequently; quarterly for portfolios of more than 100 transactions and annually otherwise[45] -- which corresponds with the requirement of Commission regulation 23.502(b)(3).

The EMIR standards require FCs to report to the relevant competent authority any disputes between counterparties relating to an OTC derivative contract, its valuation or the exchange of collateral for an amount or a value higher than €15 million and outstanding for at least 15 business days,[46] while Commission regulation 23.502(c) has a similar reporting requirement for disputes of at least $20 million outstanding from three to five days, depending on counterparty type. The EMIR standards, similar to § 23.502(a)(5), require FCs and NFCs to have detailed procedures and processes for resolving disputes related to valuation.

[44] See Article 13(3)(a) of the EMIR Regulatory Technical Standards.

[45] See Article 13(3)(b) of the EMIR Regulatory Technical Standards.

[46] See Article 15(2) of the EMIR Regulatory Technical Standards.

Generally identical in intent to § 23.502, the EMIR portfolio reconciliation standards are designed to ensure that valuation disputes are recognized and resolved in a timely manner. This regular reconciliation will assist in identifying and resolving discrepancies, which in turn will aid the entities in their collateralization and risk management.

Based on the foregoing and the representations of the applicant, the Commission finds that the portfolio reconciliation requirements of the EMIR standards submitted by the applicant are comparable to and as comprehensive as the portfolio reconciliation requirements of Commission regulation 23.502.

2. Portfolio Compression (§ 23.503)

**Commission Requirement:** Portfolio compression is a post-trade processing and netting mechanism whereby substantially similar transactions among two or more counterparties are terminated and replaced with a smaller number of transactions of decreased notional value. Portfolio compression is intended to ensure timely and accurate processing and netting of swaps,[47] and is widely acknowledged as an effective risk mitigation tool.[48]

Pursuant to § 23.503, an SD/MSP must establish policies and procedures for terminating fully offsetting uncleared swaps, when appropriate; for periodically participating in bilateral and multilateral compression exercises for uncleared swaps with

[47] For example, the reduced transaction count may decrease operational risk as there are fewer trades to maintain, process, and settle.

[48] See Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904, 55932 (Sept. 11, 2012).

other SDs/MSPs, when appropriate; and for engaging in such exercises for uncleared swaps with non-SDs/MSPs upon request.

**Regulatory Objective:** The purpose of portfolio compression is to reduce the operational risk, cost, and inefficiency of maintaining unnecessary transactions on the counterparties' books.

**Comparable EU Law and Regulations:** The applicant has represented to the Commission that the following provisions of law and regulations applicable in the EU are in full force and effect in the EU, and comparable to and as comprehensive as section 4s(i) of the CEA and Commission regulation 23.503:

- OTC RTS Art. 14: FCs and NFCs with 500 or more uncleared OTC derivative contracts outstanding with a counterparty must have procedures to regularly, and at least twice a year, analyse the possibility of conducting a portfolio compression exercise in order to reduce their counterparty credit risk and engage in such a portfolio compression exercise; and

- FCs and NFCs must ensure that they are able to provide a reasonable and valid explanation to the relevant competent authority for concluding that a portfolio compression exercise is not appropriate.

**Commission Determination:** The EMIR standards specified above require FCs and NFCs with 500 or more OTC uncleared derivative contracts outstanding with a counterparty to have procedures to regularly, and at least twice a year, analyze the possibility of conducting a portfolio compression exercise in order to reduce their counterparty credit risk and engage in such a portfolio compression exercise,[49] which

[49] See Article 14 of the EMIR Regulatory Technical Standards.

corresponds to the requirement under § 23.503 that SDs and MSPs establish procedures for periodically engaging in compression exercises with their counterparties.

Under the EMIR standards, FCs and NFCs also must ensure that they are able to provide a reasonable and valid explanation to the relevant competent authority for concluding that a portfolio compression exercise is not appropriate.[50] This requirement corresponds directly to regulation 23.503 that SDs and MSPs engage in compression exercises with their counterparties "when appropriate," which would necessarily require such registrants to demonstrate to the Commission why a compression opportunity was not appropriate.

Generally identical in intent to § 23.503, the EMIR portfolio compression standards are designed to reduce the operational risk, cost, and inefficiency of maintaining unnecessary transactions on the counterparties' books.

Based on the foregoing and the representations of the applicant, the Commission finds that the EMIR portfolio compression standards submitted by the applicant are comparable to and as comprehensive as the portfolio compression requirements of Commission regulation 23.503.

**B. Trade Confirmation (§ 23.501)**

**Commission Requirement:** Section 4s(i) of the CEA[51] requires that each SD and MSP comply with the Commission's regulations prescribing timely and accurate confirmation of swaps.

[50] See id.

[51] 7 U.S.C. § 6s(i).

Subject to an implementation period, § 23.501 requires confirmation of swap transactions (which includes execution, termination, assignment, novation, exchange, transfer, amendment, conveyance, or extinguishing of rights or obligations of a swap) among SDs and MSPs by the end of the first business day following the day of execution.

Subject to an implementation period, with respect to swaps with non-SDs/MSPs, SDs and MSPs are required to establish policies and procedures reasonably designed to ensure confirmation with non-SDs and non-MSPs by the end of the first business day following the day of execution if the counterparty is a financial entity or the end of the second business day if the counterparty is a non-financial entity.

SDs and MSPs are also required to send an acknowledgement of a swap transaction to a counterparty that is not an SD/MSP by the end of the first business day following the day of execution, and are required to provide a draft confirmation to non-SDs/MSPs prior to execution of a swap, if requested.

The day of execution is determined by reference to the business days of the counterparties and whether the swap was executed after 4:00 p.m. in the place of at least one of the counterparties.

Commission regulation 23.501 does not apply to swaps executed on a swap execution facility ("SEF") or designated contract market ("DCM") if the SEF/DCM provides for confirmation of swap transactions at the same time as execution. It also does not apply to swap transactions that are submitted for clearing by a derivatives clearing organization ("DCO") within the time required for confirmation and the DCO provides confirmation at the same time the swap transaction is accepted for clearing.

**Regulatory Objective:** Timely and accurate confirmation of swaps – together with portfolio reconciliation and compression – are important post-trade processing mechanisms for reducing risks and improving operational efficiency. Through § 23.501, the Commission seeks to ensure that both parties to a trade are informed of and agree upon all terms of a swap transaction[52] in writing in a timely manner following execution, thereby promoting post-trade processing, netting, and valuation of the swap for risk management purposes. The correct calculation of cash flows, margin requirements, discharge of settlement obligations, and accurate measurement of counterparty credit exposure are all dependent on timely and accurate confirmation.[53]

**Comparable EU Law and Regulations:** The applicant has represented to the Commission that the following provisions of law and regulations applicable in the EU are in full force and effect in the EU, and comparable to and as comprehensive as section 4s(i) of the CEA and Commission regulation 23.501.

OTC RTS Art 12.1: Subject to an implementation period, FCs and NFCs+ must have in place procedures to ensure that uncleared OTC derivatives transactions between FCs and NFCs+ are confirmed, where available via electronic means, as soon as possible and at the latest by the end of the next business day following the date of execution.

OTC RTS Art. 12.2: Subject to an implementation period, FCs and NFCs+ must have in place procedures to ensure that non-centrally cleared OTC derivatives transactions with non- FCs/NFCs+ are confirmed, where available via electronic means,

[52] Pursuant to § 23.500(l), "swap transaction" is defined to mean "any event that results in a new swap or in a change to the terms of a swap, including execution, termination, assignment, novation, exchange, transfer, amendment, conveyance, or extinguishing of rights or obligations of a swap."

[53] See Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 12 C.F.R. Part 23, 77 FR 55904 at 55917 (September 11, 2012) (Final Rule).

as soon as possible and at the latest by the end of the second business day following the date of execution.

OTC RTS Art. 12.3: For transactions concluded after 4:00 p.m. local time, or with a counterparty located in a different time zone which does not allow confirmation by the set deadline, the confirmation must take place as soon as possible and, at the latest, one business day following the deadline set out above.

OTC RTS Art. 12.4: FCs must establish the necessary procedure to report on a monthly basis to the relevant competent authority the number of unconfirmed OTC derivative transactions referred to in OTC RTS Art. 12.1 - 12.3 that have been outstanding for more than five business days.

**Commission Determination:** Pursuant to the EMIR standards specified above, and subject to a phase-in period, OTC derivative contracts entered into between FCs or NFCs+ must be confirmed as soon as possible and at the latest by the end of the next business day following the date of execution,[54] which corresponds to Commission regulation 23.501(a)(1) and (3)(i), requiring confirmation with other SDs, MSPs, and financial entities by the end of the first business day following the day of execution.

For OTC derivative contracts with all other NFCs, the EMIR standards require confirmation as soon as possible and, at the latest, by the end of the second business day following the date of execution.[55] This approach corresponds to the Commission regulation 23.501(a)(3)(ii), which requires written policies and procedures reasonably

[54] See Article 12 of the EMIR Regulatory Technical Standards.

[55] See id.

designed to ensure confirmation with non-SDs, non-MSPs, or non-financial entities by the end of the second business day following the day of execution.

As with Commission regulation 23.501(a)(5), which provides for a next business day adjustment for transactions executed after 4:00 pm or on a non-business day, the EMIR standards provide that transactions concluded after 4:00 p.m. local time, or with a counterparty located in a different time zone that does not allow confirmation by the set deadline, the confirmation must take place as soon as possible and, at the latest, one business day following the otherwise applicable deadline.

Generally identical in intent to § 23.501, the EMIR trade confirmation requirements are designed to ensure that both parties to a trade are informed of, and agree upon, all terms of a swap transaction in writing in a timely manner following execution, thereby promoting post-trade processing, netting, and valuation of the swap for risk management purposes.

Based on the foregoing and the representations of the applicant, the Commission finds that the trade confirmation requirements of the EMIR standards are comparable to and as comprehensive as the swap transaction confirmation requirements of Commission regulation 23.501.

### C. Swap Trading Relationship Documentation (§ 23.504)

**Commission Requirement:** Section 4s(i) of the CEA requires each SD and MSP to conform to Commission standards for the timely and accurate confirmation, processing, netting, documentation, and valuation of swaps.[56] Pursuant to this requirement, the Commission adopted § 23.504.

[56] See 7 U.S.C. § 6s(i).

Pursuant to § 23.504(a), SDs and MSPs must have policies and procedures reasonably designed to ensure that the SD or MSP enters into swap trading relationship documentation with each counterparty prior to executing any swap with such counterparty. Such requirement does not apply to cleared swaps.

Pursuant to § 23.504(b), SDs and MSPs must, at a minimum, document terms relating to:

- Payment obligations;
- Netting of payments;
- Events of default or other termination events;
- Netting of obligations upon termination;
- Transfer of rights/obligations;
- Governing law;
- Valuation – must be able to value swaps in a predictable and objective manner – complete and independently verifiable methodology for valuation;
- Dispute resolution procedures; and
- Credit support arrangements with initial/variation margin at least as high as set for SD/MSPs or prudential regulator (identifying haircuts and class of eligible assets).

**Regulatory Objective:** Through Commission regulation 23.504, the Commission seeks to reduce the legal, operational, counterparty credit, and market risk that can arise from undocumented swaps or undocumented terms of swaps. Inadequate documentation of swap transactions is more likely to result in collateral and legal disputes, thereby exposing counterparties to significant counterparty credit risk.

In particular, documenting agreements regarding valuation is critical because, as the Commission has noted, the ability to determine definitively the value of a swap at any given time lies at the center of many of the OTC derivatives market reforms contained in the Dodd-Frank Act and is a cornerstone of risk management. With respect to other SDs/MSPs and financial entities, or upon request of any other counterparty, the regulation requires agreement on the process (including alternatives and dispute resolution procedures) for determining the value of each swap for the duration of such swap for purposes of complying with the Commission's margin and risk management requirements, with such valuations based on objective criteria to the extent practicable.

**Comparable EU Law and Regulations:** The applicant has represented to the Commission that the following provisions of law and regulations applicable in the EU are in full force and effect in the EU, and comparable to and as comprehensive as section 4s(i) of the CEA and Commission regulation 23.504.

MiFID requires counterparties to be classified as retail clients, professional clients,[57] and eligible counterparties,[58] and corresponding different conduct of business rules apply.[59] Investment firms have to correctly categorize clients and notify those clients of their classification; furthermore, investment firms should be able to demonstrate the correctness of the classification.

Firms have to conclude agreements with retail and professional clients setting out the respective rights and obligations and any other terms for the provision of the

[57] Annex II of MiFID.

[58] Article 24 MiFID.

[59] Article 19 MiFID and 28 to 34 of MiFID L2D.

services.[60] Ex-ante information has to be provided to clients on the services provided, the risks, and the safeguarding of their assets.[61] Adequate ex-post reports also have to be provided.[62] Irrespective of the classification of clients, specific record-keeping obligations regulate the recording of client orders and transactions.[63]

With respect to dispute resolution, when concluding OTC derivative contracts with each other, FCs and NFCs must have agreed detailed procedures and processes in relation to: (a) the identification, recording, and monitoring of disputes relating to the recognition or valuation of the contract and to the exchange of collateral between counterparties, and (b) the resolution of disputes in a timely manner with a specific process for handling those disputes that are not resolved within five business days. Those procedures must at least record the length of time for which the dispute remains outstanding, the counterparty, and the amount which is disputed.[64]

**Commission Determination:** The EMIR standards specified above require OTC derivative contracts entered into between FCs or NFCs to be confirmed in writing,[65] which corresponds to the requirements of Commission regulation 23.504(b)(2).

Pursuant to EMIR Article 11, FCs and NFCs+ are required to value outstanding OTC derivatives contracts on a mark-to-market basis daily, or where market conditions

[60] Article 19 (7) MiFID.

[61] Article 19 (3) MiFID and Articles 29-33 MiFID L2D.

[62] Article 19 (8) MiFID and Articles 40-43 of MiFID L2D.

[63] Article 51 MiFID L2D and Articles 7-8 and Annex I, table I of MiFID L2R.

[64] EMIR Art. 11 and OTC RTS Art 15.

[65] *See* Article 12 of the EMIR Regulatory Technical Standards.

determine otherwise, a "reliable and prudent marking to model" may be used.[66] This corresponds with Commission regulation 23.504(b)(4)(i), which requires SDs and MSPs to engage in daily valuation with other SDs and MSPs, and financial entities, but allows such procedures to be included in documentation with NFCs to the extent such counterparties request them.

Under the EMIR standards, when concluding OTC derivative contracts with each other, counterparties must have agreed detailed procedures and processes in relation to the identification, recording, and monitoring of disputes relating to the recognition or valuation of the contracts and to the exchange of collateral between counterparties and in relation to the resolution of disputes in a timely manner, including a specific process for handling disputes that are not resolved within five business days. These aspects of the EMIR standards correspond to the valuation documentation requirements under Commission regulation 23.504(b)(4), which also require use of market transactions for valuations to the extent practicable, or other objective criteria, and an agreement on detailed processes for valuation dispute resolution for purposes of complying with margin requirements.

Generally identical in intent to § 23.504(b)(2) and (4), the EMIR confirmation and valuation documentation requirements are designed to reduce the legal, operational, counterparty credit, and market risk that can arise from undocumented transactions or terms, reducing the risk of collateral and legal disputes, and exposure of counterparties to significant counterparty credit risk.

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[66] *See* Article 11(2) of EMIR. See also Article 16 of the EMIR Regulatory Technical Standards (describing the market conditions that prevent marking-to-market) and Article 17 of the EMIR Regulatory Technical Standards (describing the criteria for using marking-to-model).

Based on the foregoing and the representations of the applicant, the Commission finds the confirmation and valuation documentation requirements of the EMIR standards specified above are comparable to and as comprehensive as the swap trading relationship documentation requirements of Commission regulations § 23.504(b)(2) and (4).

For the avoidance of doubt the Commission notes that the foregoing comparability determination only applies with regard to two provisions of § 23.504 (i.e., § 23.504(b)(2) and (4)). No comparability finding is made regarding the other provisions of § 23.504, namely § 23.504(a)(2) and (c)(2), that SDs and MSPs establish policies and procedures, approved in writing by senior management of the SD or MSP, reasonably designed to ensure that they have entered into swap trading relationship documentation with each counterparty prior to or contemporaneously with entering into a swap transaction with such counterparty.[67]

Moreover, the foregoing comparability determination does not extend to the requirement that such documentation include terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, governing law, dispute resolution, and credit support arrangements, as well as notice of the status of the counterparty under the orderly liquidation procedures of Title II of the Dodd-Frank Act, and the effect of clearing on swaps executed bilaterally.[68] Nor does this determination relieve an SD or MSP from the documentation audit and recordkeeping requirements under § 23.504(c) and (d).

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[67] See Commission regulation 23.504(a)(2), 17 CFR 23.504(c)(2).

[68] See § 23.504(b)(1), (3), (5), and (6).

### D. Daily Trading Records (§ 23.202)

**Commission Requirement:** Section 4s(g)(1) of the CEA and Commission regulation 23.202 generally require that SDs and MSPs retain daily trading records for swaps and related cash and forward transactions, including:

- Documents on which transaction information is originally recorded;
- All information necessary to conduct a comprehensive and accurate trade reconstruction;
- Pre-execution trade information including records of all oral and written communications concerning quotes, solicitations, bids, offers, instructions, trading, and prices that lead to the execution of a swap or related cash and forward transactions, whether communicated by phone, fax, instant messaging, chat rooms, e-mail, mobile device, or other digital or electronic media;
- Reliable timing date for the initiation of a trade;
- A record of the time, to the nearest minute using Coordinated Universal Time (UTC), of each quotation provided or received prior to trade execution;
- Execution trade information including the terms of each swap and related cash or forward transaction, terms regarding payment or settlement, initial and variation margin requirements, option premiums, and other cash flows;
- The trade ticket for each swap and related cash or forward transaction;
- The date and time of execution of each swap and related cash or forward transaction to the nearest minute using UTC;

- The identity of the counterparty and the date and title of the agreement to which each swap is subject, including any swap trading relationship documentation and credit support arrangements;
- The product name and identifier, the price at which the swap was executed, and the fees, commissions and other expenses applicable;
- Post-execution trade information including records of confirmation, termination, novation, amendment, assignment, netting, compression, reconciliation, valuation, margining, collateralization, and central clearing;
- The time of confirmation to the nearest minute using UTC;
- Ledgers of payments and interest received, moneys borrowed and loaned, daily swap valuations, and daily calculation of current and potential future exposure for each counterparty;
- Daily calculation of initial and variation margin requirements;
- Daily calculation of the value of collateral, including haircuts;
- Transfers of collateral, including substitutions, and the types of collateral transferred; and
- Credits and debits for each counterparty's account.

Daily trading records must be maintained in a form and manner identifiable and searchable by transaction and counterparty, and records of swaps must be maintained for the duration of the swap plus five years, and voice recordings for one year. Records must be "readily accessible" for the first two years of the five year retention period (consistent with § 1.31).

**Regulatory Objective:** Through § 23.202, the Commission seeks to ensure that an SD's or MSP's records include all information necessary to conduct a comprehensive and accurate trade reconstruction for each swap, which necessarily requires the records to be identifiable by transaction and counterparty. Complete and accurate trade reconstruction is critical for both regulatory oversight and investigations of illegal activity pursuant to the Commission's enforcement authority. The Commission believes that a comprehensive and accurate trade reconstruction requires records of pre-execution, execution, and post-execution trade information.

**Comparable EU Law and Regulations:** The applicant has represented to the Commission that the following provisions of law and regulations applicable in the EU are in full force and effect in the EU, and comparable to and as comprehensive as section 4s(g) of the CEA and Commission regulation 23.202.

MiFID Article 13.6 and MiFID L2D Articles 5.1.f and 51: Firms are required to maintain records of all services and transactions undertaken by the firm that are sufficient to enable regulator authorities to monitor compliance with MiFID and to ascertain whether the firm has complied with all obligations with respect to clients or potential clients.

Firms are required to keep detailed records in relation to every client order and decision to deal, and every client order executed or transmitted.

All required records must be retained in a medium available for future reference by the regulator, and in a form/manner that:

- Allows the regulator to access them readily and reconstitute each key stage of processing each transaction;

- Allows corrections or other amendments, and the contents of the records prior to such corrections or amendments, to be easily ascertained; and
- Ensures that records are not manipulated or altered.

MiFID Article 25(2): Firms must keep at the disposal of the regulator, for at least five years, the relevant data relating to all transactions in financial instruments which they have carried out, whether on their own account or on behalf of a client.

MiFID L2R Articles 9 to 16: Requires transaction reporting in order to provide the competent authorities with the necessary information to conduct proper market surveillance.

Investment firms are required to report details of all executed transactions in any financial instruments admitted to trading on a Regulated Market to the competent authority as quickly as possible and no later than the close of the following working day.

The content of the transaction report is specified in L2 measures (MiFID L2R Article 13).

The reporting obligation lies with investment firms. In a case where all the required information with respect to derivatives transactions has been transmitted to a TR that transmits this information onwards to the competent authority the obligation on the investment firm to report will be waived.

**Commission Determination:** The Commission finds that compliance with MiFID would enable the relevant competent authority to conduct a comprehensive and accurate trade reconstruction for each swap, which the Commission finds generally meets the regulatory objective of § 23.202. However, the request did not provide any basis on which the Commission could determine that MiFID or EMIR are comparable to and as

comprehensive as § 23.202(a)(1) or regulation 23.202(b)(1), which require records of oral communications to be maintained for swap transactions and related cash and forward transactions, respectively, including telephone, voicemail, and mobile device recordings.[69]

Based on the foregoing and the representations of the applicant, the Commission hereby determines that the daily trading records requirements of MiFID are comparable to and as comprehensive as § 23.202, excepting § 23.202(a)(1) and (b)(1). This determination is limited to the content of the recordkeeping requirements of § 23.202 (excepting subsections (a)(1) and (b)(1)) and does not extend to the requirement that the Commission and any U.S. prudential regulator of an SD or MSP have direct access to such records.[70]

Issued in Washington, DC on December 20, 2013, by the Commission.

Christopher J. Kirkpatrick,

Deputy Secretary of the Commission.

[69] In the EU's request for a comparability determination proposed regulations concerning the recording of oral communications were submitted. These requirements are currently under negotiation. The Commission may reconsider the EU's request when and if the proposal is enacted.

[70] Unless the records required by MiFID are available to the Commission and any U.S. prudential regulator under the foreign legal regime, it would be impossible to meet the regulatory objective of § 23.202. As stated in the Guidance, the ability to rely on a substituted compliance regime is dependent on direct access to the books and records of a registrant. This is the case with respect to any Transaction-Level Requirement, and not only the daily trading records required by § 23.202. See 78 FR at 45344-45.

**Appendices to Comparability Determination for the European Union: Certain Transaction-Level Requirements**

**Appendix 1 – Commission Voting Summary**

On this matter, Chairman Gensler and Commissioners Chilton and Wetjen voted in the affirmative. Commissioner O'Malia voted in the negative.

**Appendix 2 – Joint Statement of Chairman Gary Gensler and Commissioners Bart Chilton and Mark Wetjen**

We support the Commission's approval of broad comparability determinations that will be used for substituted compliance purposes. For each of the six jurisdictions that has registered swap dealers, we carefully reviewed each regulatory provision of the foreign jurisdictions submitted to us and compared the provision's intended outcome to the Commission's own regulatory objectives. The resulting comparability determinations for entity-level requirements permit non-U.S. swap dealers to comply with regulations in their home jurisdiction as a substitute for compliance with the relevant Commission regulations.

These determinations reflect the Commission's commitment to coordinating our efforts to bring transparency to the swaps market and reduce its risks to the public. The comparability findings for the entity-level requirements are a testament to the comparability of these regulatory systems as we work together in building a strong international regulatory framework.

In addition, we are pleased that the Commission was able to find comparability with respect to swap-specific transaction-level requirements in the European Union and Japan.

The Commission attained this benchmark by working cooperatively with authorities in Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland to reach mutual agreement. The Commission looks forward to continuing to collaborate with both foreign authorities and market participants to build on this progress in the months and years ahead.

**Appendix 3 – Statement of Dissent by Commissioner Scott D. O'Malia**

I respectfully dissent from the Commodity Futures Trading Commission's ("Commission") approval of the Notices of Comparability Determinations for Certain Requirements under the laws of Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland (collectively, "Notices"). While I support the narrow comparability determinations that the Commission has made, moving forward, the Commission must collaborate with foreign regulators to harmonize our respective regimes consistent with the G-20 reforms.

However, I cannot support the Notices because they: (1) are based on the legally unsound cross-border guidance ("Guidance");[1] (2) are the result of a flawed substituted compliance process; and (3) fail to provide a clear path moving forward. If the Commission's objective for substituted compliance is to develop a narrow rule-by-rule approach that leaves unanswered major regulatory gaps between our regulatory framework and foreign jurisdictions, then I believe that the Commission has successfully achieved its goal today.

**Determinations Based on Legally Unsound Guidance**

[1] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292 (Jul. 26, 2013).

As I previously stated in my dissent, the Guidance fails to articulate a valid statutory foundation for its overbroad scope and inconsistently applies the statute to different activities.[2] Section 2(i) of the Commodity Exchange Act ("CEA") states that the Commission does not have jurisdiction over foreign activities unless "those activities have a direct and significant connection with activities in, or effect on, commerce of the United States …."[3] However, the Commission never properly articulated how and when this limiting standard on the Commission's extraterritorial reach is met, which would trigger the application of Title VII of the Dodd-Frank Act[4] and any Commission regulations promulgated thereunder to swap activities that are outside of the United States. Given this statutorily unsound interpretation of the Commission's extraterritorial authority, the Commission often applies CEA section 2(i) inconsistently and arbitrarily to foreign activities.

Accordingly, because the Commission is relying on the legally deficient Guidance to make its substituted compliance determinations, and for the reasons discussed below, I cannot support the Notices. The Commission should have collaborated with foreign regulators to agree on and implement a workable regime of substituted compliance, and then should have made determinations pursuant to that regime.

**Flawed Substituted Compliance Process**

Substituted compliance should not be a case of picking a set of foreign rules identical to our rules, determining them to be "comparable," but then making no

[2] http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement071213b.

[3] CEA section 2(i); 7 U.S.C. 2(i).

[4] Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

determination regarding rules that require extensive gap analysis to assess to what extent each jurisdiction is, or is not, comparable based on overall outcomes of the regulatory regimes. While I support the narrow comparability determinations that the Commission has made, I am concerned that in a rush to provide some relief, the Commission has made substituted compliance determinations that only afford narrow relief and fail to address major regulatory gaps between our domestic regulatory framework and foreign jurisdictions. I will address a few examples below.

First, earlier this year, the OTC Derivatives Regulators Group ("ODRG") agreed to a number of substantive understandings to improve the cross-border implementation of over-the-counter derivatives reforms.[5] The ODRG specifically agreed that a flexible, outcomes-based approach, based on a broad category-by-category basis, should form the basis of comparability determinations.[6]

However, instead of following this approach, the Commission has made its comparability determinations on a rule-by-rule basis. For example, in Japan's Comparability Determination for Transaction-Level Requirements, the Commission has made a positive comparability determination for some of the detailed requirements under the swap trading relationship documentation provisions, but not for other requirements.[7] This detailed approach clearly contravenes the ODRG's understanding.

[5] http://www.cftc.gov/PressRoom/PressReleases/pr6678-13.

[6] http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/odrgreport.pdf. The ODRG agreed to six understandings. Understanding number 2 states that "[a] flexible, outcomes-based approach should form the basis of final assessments regarding equivalence or substituted compliance."

[7] The Commission made a positive comparability determination for Commission regulations 23.504(a)(2), (b)(1), (b)(2), (b)(3), (b)(4), (c), and (d), but not for Commission regulations 23.504(b)(5) and (b)(6).

Second, in several areas, the Commission has declined to consider a request for a comparability determination, and has also failed to provide an analysis regarding the extent to which the other jurisdiction is, or is not, comparable. For example, the Commission has declined to address or provide any clarity regarding the European Union's regulatory data reporting determination, even though the European Union's reporting regime is set to begin on February 12, 2014. Although the Commission has provided some limited relief with respect to regulatory data reporting, the lack of clarity creates unnecessary uncertainty, especially when the European Union's reporting regime is set to begin in less than two months.

Similarly, Japan receives no consideration for its mandatory clearing requirement, even though the Commission considers Japan's legal framework to be comparable to the U.S. framework. While the Commission has declined to provide even a partial comparability determination, at least in this instance the Commission has provided a reason: the differences in the scope of entities and products subject to the clearing requirement.[8] Such treatment creates uncertainty and is contrary to increased global harmonization efforts.

Third, in the Commission's rush to meet the artificial deadline of December 21, 2013, as established in the Exemptive Order Regarding Compliance with Certain Swap Regulations ("Exemptive Order"),[9] the Commission failed to complete an important piece of the cross-border regime, namely, supervisory memoranda of understanding ("MOUs") between the Commission and fellow regulators.

[8] Yen-denominated interest rate swaps are subject to the mandatory clearing requirement in both the U.S. and Japan.

[9] Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 FR 43785 (Jul. 22, 2013).

I have previously stated that these MOUs, if done right, can be a key part of the global harmonization effort because they provide mutually agreed-upon solutions for differences in regulatory regimes.[10] Accordingly, I stated that the Commission should be able to review MOUs alongside the respective comparability determinations and vote on them at the same time. Without these MOUs, our fellow regulators are left wondering whether and how any differences, such as direct access to books and records, will be resolved.

Finally, as I have consistently maintained, the substituted compliance process should allow other regulatory bodies to engage with the full Commission.[11] While I am pleased that the Notices are being voted on by the Commission, the full Commission only gained access to the comment letters from foreign regulators on the Commission's comparability determination draft proposals a few days ago. This is hardly a transparent process.

**Unclear Path Forward**

Looking forward to next steps, the Commission must provide answers to several outstanding questions regarding these comparability determinations. In doing so, the Commission must collaborate with foreign regulators to increase global harmonization.

First, there is uncertainty surrounding the timing and outcome of the MOUs. Critical questions regarding information sharing, cooperation, supervision, and enforcement will remain unanswered until the Commission and our fellow regulators execute these MOUs.

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[10] http://www.cftc.gov/PressRoom/SpeechesTestimony/opaomalia-29.

[11] http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliastatement071213b.

Second, the Commission has issued time-limited no-action relief for the swap data repository reporting requirements. These comparability determinations will be done as separate notices. However, the timing and process for these determinations remain uncertain.

Third, the Commission has failed to provide clarity on the process for addressing the comparability determinations that it declined to undertake at this time. The Notices only state that the Commission may address these requests in a separate notice at a later date given further developments in the law and regulations of other jurisdictions. To promote certainty in the financial markets, the Commission must provide a clear path forward for market participants and foreign regulators.

The following steps would be a better approach: (1) the Commission should extend the Exemptive Order to allow foreign regulators to further implement their regulatory regimes and coordinate with them to implement a harmonized substituted compliance process; (2) the Commission should implement a flexible, outcomes-based approach to the substituted compliance process and apply it similarly to all jurisdictions; and (3) the Commission should work closely with our fellow regulators to expeditiously implement MOUs that resolve regulatory differences and address regulatory oversight issues.

**Conclusion**

While I support the narrow comparability determinations that the Commission has made, it was my hope that the Commission would work with foreign regulators to implement a substituted compliance process that would increase the global harmonization effort. I am disappointed that the Commission has failed to implement such a process.

I do believe that in the longer term, the swaps regulations of the major jurisdictions will converge. At this time, however, the Commission's comparability determinations have done little to alleviate the burden of regulatory uncertainty and duplicative compliance with both U.S. and foreign regulations.

The G-20 process delineated and put in place the swaps market reforms in G-20 member nations. It is then no surprise that the Commission must learn to coordinate with foreign regulators to minimize confusion and disruption in bringing much needed clarity to the swaps market. For all these shortcomings, I respectfully dissent from the Commission's approval of the Notices.

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