

May 16, 2019

## **IMPACT OF CFTC'S PROPOSED AMENDMENTS TO SWAP DATA REPORTING REQUIREMENTS ON REPORTING AND NON-REPORTING COUNTERPARTIES**

To Our Clients and Friends:

On May 13, 2019, the Commodity Futures Trading Commission (the "Commission" or the "CFTC") published a notice of proposed rulemaking titled *Proposed Amendments to the Commission's Regulations Relating to Certain Swap Data Repository and Data Reporting Requirements* (the "Proposal").<sup>[1]</sup> The Proposal seeks to modify existing swap data reporting requirements in Part 23 of the Commission's regulations for swap dealers ("SDs") and major swap participants ("MSPs"), Parts 43 and 45 of the Commission's regulations for "reporting parties" and "reporting counterparties" (as such terms are defined in the Commission's regulations),<sup>[2]</sup> and Part 49 of the Commission's regulations for swap data repositories ("SDRs"). The Proposal is the first rulemaking adopted by the CFTC following its Division of Market Oversight's (the "Division") July 2017 comprehensive analysis of the CFTC's swap data reporting regulations, which was titled the *Roadmap to Achieve High Quality Swaps Data* (the "Roadmap").<sup>[3]</sup> In the Roadmap, the Division solicited public feedback on potential improvements to the CFTC's swap data reporting regime in a manner that would achieve the CFTC's regulatory goals of swap data transparency under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")<sup>[4]</sup> without imposing unnecessary burdens on market participants.

Consistent with the Roadmap's goals, the CFTC's expressed objectives in adopting the Proposal are to "improve the accuracy of data reported to, and maintained by, SDRs," "require reporting counterparties to verify the accuracy of swap data pursuant to [...] SDR procedures," and "provide enhanced and streamlined oversight over SDRs and data reporting generally."<sup>[5]</sup> The CFTC notes that the Proposal is the first of three planned rulemakings as described in the Roadmap.<sup>[6]</sup> While most of the Proposal's amendments are intended to modify Part 49 of the Commission's regulations, which covers SDR registration requirements, SDR operational duties, and the CFTC's oversight over SDRs generally, the Proposal also would make certain substantive amendments to the swap data reporting requirements for SDs and MSPs under Part 23 and reporting counterparties (and non-reporting counterparties) under Parts 43 and 45 (the "Counterparty Reporting Rules").<sup>[7]</sup> This Client Alert focuses on the Proposal's modifications to the Counterparty Reporting Rules. With respect to the Counterparty Reporting Rules, the Proposal notes that current swap data that is available to the CFTC lacks accuracy. This view has been specifically echoed by CFTC Chairman J. Christopher Giancarlo and several other past and current CFTC Commissioners.<sup>[8]</sup>

To address these concerns regarding accuracy and data quality, the Proposal includes specific amendments to the Counterparty Reporting Rules. In particular, the Proposal, if adopted, would establish: (1) new swap data accuracy verification requirements for reporting counterparties within

certain timeframes depending on the type of reporting counterparty (*i.e.*, different requirements for SDs/MSPs versus non-SDs/MSPs); (2) revisions to existing swap data error and omission rules for reporting counterparties; and (3) enhanced requirements for SDs and MSPs in terms of their written policies and procedures for swap data reporting under Parts 43 and 45 of the Commission's regulations. In the sections below, we have summarized each of these three proposed amendments to the Counterparty Reporting Rules and its impact on the reporting counterparties.

The Proposal's comment period deadline is July 29, 2019. Since the Proposal and two anticipated proposed rulemakings that are expected to follow will address interconnected issues, the CFTC plans to re-open the comment period for the Proposal at the same time it issues each anticipated rulemaking so that commenters can provide comments on the three rulemakings altogether.

Please contact a member of Gibson Dunn's Derivatives Team if you have any questions regarding the Proposal.

## ***1. Swap Data Verification***

The Proposal, if adopted, would establish new swap data accuracy verification requirements for reporting counterparties within certain timeframes depending on the type of reporting counterparty. The Proposal's amendments relating to data verification fall under Part 45 of the Commission's regulations, which generally focuses on the duties of reporting counterparties to report swap data to SDRs for regulatory purposes. The current Counterparty Reporting Rules do not explicitly require reporting counterparties to verify the data reported with the relevant SDR. However, the Proposal would create a mandate that all reporting counterparties must verify their swap data for accuracy and completeness with reports provided by the SDR.<sup>[9]</sup> Effectively, the Proposal would require a reporting counterparty to reconcile their internal books and records for each open swap against any and all open swaps reflected in an open swap report received from an SDR.<sup>[10]</sup> Further, reporting counterparties would be required to conform to any swap data verification policies and procedures enacted by an SDR.<sup>[11]</sup>

The Proposal includes specific timing requirements for reporting counterparty data verification as well as the timing of the frequency of the open swaps reports to be distributed by the SDR. The open swaps reports must be distributed by the SDR to SD, MSP and DCO reporting counterparties on a weekly basis and to non-SD and non-MSP reporting counterparties on a monthly basis.<sup>[12]</sup> Upon receipt and review of the open swaps report, reporting counterparties must submit either a (i) verification of data accuracy<sup>[13]</sup> or (ii) notice of discrepancy in response to every open swaps report received from an SDR within the following timeframes: (a) 48 hours of the SDR's providing the open swaps report if the reporting counterparty is a SD or MSP; or (b) 96 hours of the SDR's providing the open swaps report for non-SD/MSP reporting counterparties.<sup>[14]</sup> In the event that the reporting counterparty finds no discrepancies between its books and records and the data in the SDR's open swap report, the reporting counterparty must nonetheless submit a verification of data accuracy indicating that the swap data is complete and accurate to the SDR in accordance with the aforementioned timing requirements.<sup>[15]</sup> If, however, the reporting counterparty finds a discrepancy in the swap data (*i.e.*, over-reporting or under-reporting), the reporting counterparty must submit a notice of discrepancy to the SDR in accordance with the timing outlined above.<sup>[16]</sup>

The Commission explains that the Proposal's swap data verification rules aim to improve swap data quality by facilitating the swift resolution of any discrepancies between the swap data maintained by an SDR and the information on record with a reporting counterparty. However, the data verification requirements of the Proposal would impose new and notable obligations on all reporting counterparties (including smaller, non-SD/non-MSP reporting counterparties) that are not in existence under today's reporting rules. In particular, the Proposal would require reporting counterparties to review the SDR's policies and procedures around the verification process, to build comprehensive systems to verify the swap data reported to the SDR by comparing its internal records against open swaps reports received from the SDR, and to send verification or discrepancy notices to the SDR within relatively short timeframes. As reporting counterparties already report information to SDRs under the Counterparty Reporting Rules, the Commission expressed its belief that SDRs and reporting counterparties would coordinate with one another to implement a system which is efficient and convenient for both parties, with particular attention to not be unnecessarily burdensome to non-SD/MSP and non-derivatives clearing organization reporting counterparties.<sup>[17]</sup> Further, many reporting counterparties report swap data to more than one SDR and given that each SDR will have its own unique policies and procedures, the verification process will differ between SDRs.

## **2. *Changes to Errors and Omissions Reporting***

If adopted, the Proposal would also revise the swap data error and omission correction requirements for reporting counterparties.<sup>[18]</sup> Currently, the error and omission correction requirements under Part 43 and those under Part 45 have substantive differences from one another. For example, Part 43 requires a reporting counterparty that "becomes aware of an error or omission in the swap transaction and pricing data" to "promptly notify the other party of the error and/or correction" while Part 45 does not have a similar notification requirement for the reporting counterparty to provide such notice.<sup>[19]</sup> The Proposal would seek to fix the gaps between the two rules and would require reporting counterparties to correct any errors and omissions to which they may be aware, including, but not limited to, errors or omissions present in the swap data in the open swaps reports provided as part of the verification process specific in the Proposal. For example, Proposed regulations 43.3(e)(1) and 45.14(b)(1) provide that to the extent that a reporting counterparty becomes aware of any error or omission in swap data previously reported to an SDR, the reporting counterparty must submit corrected swap data to the SDR.<sup>[20]</sup> The error and omissions correction requirements would apply regardless of the state of the swap. In other words, it would include the correction of live swaps and swaps that are no longer active (*i.e.*, which are commonly referred to as "dead trades").

In addition, the Proposal would establish specific error and correction procedures for reporting counterparties. In particular, the Proposal would retain the current error and correction procedure in the Counterparty Reporting Rules that requires reporting counterparties to correct swap data "as soon as technologically practicable" following discovery of the errors or omissions.<sup>[21]</sup> The Proposal would modify the "as soon as technologically practicable" timing requirement by creating a backstop of three business days after the discovery of the error or omission.<sup>[22]</sup> In the event that the reporting counterparty is unable to correct errors or omissions within three business days of discovery, the Proposal would require the reporting counterparty to immediately inform the Director of DMO, or such other CFTC employees whom the Director of DMO may designate, in writing, of the errors or omissions and

provide an initial assessment of the scope of the errors or omissions and an initial remediation plan for correcting the errors or omissions.[23] Proposed regulations 43.3(e)(1)(iii) and 45.14(b)(1)(iii) would require that a reporting counterparty conform to the SDR's policies and procedures for correction of errors and omissions that the SDRs would be required to create under the Proposal.[24]

The Proposal would also establish new requirements for non-reporting counterparties. Proposed regulations 43.3(e)(2) and 45.14(b)(2) would require a non-reporting counterparty that "by any means becomes aware" of an error or omission in swap data previously reported to an SDR, or the omission of swap data for a swap that was not previously reported to an SDR as required, to notify its counterparty to the swap (*i.e.*, the reporting counterparty) as soon as technologically practicable following discovery of the errors or omissions, but no later than three business days following the discovery of the errors or omissions.[25] This section of the Proposal also specifies that a non-reporting counterparty that does not know the identity of the reporting counterparty for a swap must notify the SEF or DCM where the swap was executed of the errors or omissions as soon as technologically practicable following discovery of the errors or omissions, but no later than three business days after the discovery.[26] In the Proposal, the Commission expressed its hope that the requirement to correct all swap data, regardless of status, would ensure that reporting counterparties establish and maintain properly functioning reporting systems to prevent the reporting of errors or omissions.

The Proposal's modifications to the errors and omissions correction requirements would notably make Parts 43 and 45 of the Commission's regulations consistent in this regard. In particular, the Proposal would remove the counterparty notification requirement set forth in current CFTC regulation 43.3(e)(1)(i). However, the Proposal would create a more definitive timeframes in which reporting counterparties are required to correct errors and omissions and in which non-reporting counterparties are required to notify their counterparties of any such errors or omissions. With respect to non-reporting counterparties, the current rules require that when a non-reporting counterparty "discovers" an error or omission it must "promptly notify" the reporting counterparty of such error or omission. The Proposal would create more stringent requirements in this regard such that non-reporting counterparties that merely become "aware" of an error or omission by "any means" must notify the reporting counterparty "as soon as technologically practicable" but no later than three business days. Further the Proposal clarifies that the non-reporting counterparty's notification obligation with respect to omissions extends to data that was not reported to an SDR (but that presumably should have been reported).

### **3. *SD and MSP Requirements***

The Proposal would also establish enhanced requirements for SDs and MSPs with respect their written policies and procedures for swap data reporting under parts 23, 43, and 45 of the Commission's regulations. Under the current regime, SDs and MSPs are required to report all information and swap data required for swap transactions when they are reporting counterparties for purposes of regulatory and real-time public reporting.[27] SDs and MSPs are also required to implement electronic systems and procedures necessary to transmit electronically all information and swap data required to be reported in accordance with Part 43 and Part 45.[28] The Proposal would require each SD and MSP to establish, maintain and enforce written policies and procedures that are reasonably designed to ensure that the SD and MSP comply with all obligations to report swap data to an SDR, which would include any

requirements under Part 43 and Part 45, as well as any rules established by the SDR.[29] The preamble to the Proposal sets forth specific content that would be expected to be included in the SD or MSP's policies and procedures.[30]

The Proposal also would require SDs and MSPs to review their policies and procedures on an annual basis and to update them as needed to reflect the requirements in Part 43 and Part 45.[31] The Commission believes that the annual review requirement in the Proposal would ensure that SDs' and MSPs' policies and procedures remain current and effective over time. SDs and MSPs are currently expected to establish policies and procedures related to all of their swap market activities, including their swap data reporting obligations.[32] The Proposal's amendments to Part 23 would make the expectations around these policies and procedures explicit by creating new obligations and setting forth guidance around content regarding reporting policies and procedures, rather than merely cross-referencing Parts 43 and 45 as we see under the current regulations.

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[1] Certain Swap Data Repository and Data Reporting Requirements, 84 Fed. Reg. 21044 (May 13, 2019).

[2] See 17 C.F.R. § 43.3(a)(3) (sets forth the determination of which counterparty to a swap transaction is the "reporting party" and has the obligation to report swap data to an SDR for purposes of real-time public reporting); 17 C.F.R. § 45.8 (sets forth the determination of which counterparty to a swap transaction is the "reporting counterparty" and has the obligation to report swap data to an SDR for purposes of regulatory reporting). For purposes of this Client Alert, the term "reporting counterparty" will refer to both a "reporting party" under Part 43 and a "reporting counterparty" under Part 45.

[3] Division of Market Oversight, *Roadmap to Achieve High Quality Swaps Data*, U.S. Commodity Futures Trading Commission, July 10, 2017, available at [http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dmo\\_swapdataplan071017.pdf](http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/dmo_swapdataplan071017.pdf).

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. 1376, Pub. Law 111-203 (July 21, 2010), as amended.

[5] Proposal at 21044.

[6] Proposal at 21045.

[7] The Proposal also includes proposed amendments to the reporting requirements for derivatives clearing organizations ("DCOs"), swap execution facilities ("SEFs"), and designated contract markets ("DCMs") to the extent that these entities are also reporting counterparties. This Client Alert is focused on the Proposal's specific impact on the Counterparties and, for that reason, does not discuss the proposed amendments impacting DCOs, SEFs, and DCMs.

[8] Speech by Commissioner J. Christopher Giancarlo, *Making Market Reform Work for America* (Jan. 18, 2017), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-19> (“The CFTC has faced many challenges in optimizing swap data ranging from data field standardization and data validation to analysis automation and cross-border data aggregation and sharing. Market participants vary significantly in how they report the same data field to SDRs. Those same SDRs vary in how they report the data to the CFTC”).

Statement by Commissioner Scott D. O’Malia, SIFMA Compliance and Legal Society Annual Seminar (Mar. 19, 2013), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opaomalia-22> (“In a rush to promulgate the reporting rules, the Commission failed to specify the data format reporting parties must use when sending their swaps to SDRs. In other words, the Commission told the industry what information to report, but didn’t specify which language to use. This has become a serious problem. . . . The end result is that even when market participants submit the correct data to SDRs, the language received from each reporting party is different. In addition, data is being recorded inconsistently from one dealer to another.”).

Speech by Commissioner Dan M. Berkovitz, *Proposed Amendments to the Commission’s Regulations Relating to Certain Swap Data Repository and Data Reporting Requirements* (Apr. 25, 2019), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement042519> (“Accurate, complete, and timely information is therefore vital to any successful swap data reporting regime. These objectives were central to post-crisis reform efforts, and they must remain the primary considerations as the Commission moves to enhance its reporting rules”).

[9] Proposal at 21098. Proposed § 45.14(a) addresses the verification of swap data accuracy against the SDR’s open swaps report.

[10] Proposal at 21098. Proposed § 45.14(a)(1) addresses a reporting counterparty’s requirement to verify the accuracy and completeness against the open swap reports from the SDR.

[11] Proposal at 21103. Proposed § 49.11 would set forth rules around such SDR policies and procedures relating to verification of swap data accuracy and would require the SDR to verify the accuracy of the data with reporting counterparties.

[12] Proposal at 21103. Proposed §§ 49.11(b)(2) and (3) address the timing obligations for SDRs to distribute open swaps reports to reporting counterparties.

[13] For purposes of clarification, examples of unsatisfactory verification may include: (i) failure to perform the verification in a timely manner and (ii) providing a verification of data accuracy indicating that the swap data was complete and accurate for swap that was not correct when verified.

[14] Proposal at 21098. Proposed § 45.14(a)(2) addresses the timing in which such verification against the open swap reports from the SDR must occur. This proposed requirement would also treat DCO reporting counterparties in the same way it does SD and MSP reporting counterparties.

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[15] Proposal at 21098. Proposed § 45.14(a)(3) addresses the requirement to submit a verification of data accuracy regardless of whether there are discrepancies identified. Such verification would be required to be submitted in the form and manner required by the SDR's swap data verification policies and procedures.

[16] Proposal at 21098. Proposed § 45.14(a)(4) addresses the requirement to submit a notice of discrepancy in the event of any inconsistencies. Such notice of discrepancy would need to be submitted in the form and manner required by the SDR's swap data verification policies and procedures.

[17] Proposal at 21068.

[18] Proposal at 21097-21099. Proposed §§ 43.3(e) and 45.14(b) address the error and omission correction requirements for Parts 43 and 45 of the CFTC's regulations.

[19] 17 C.F.R. § 43.3(e)(1)(i).

[20] Proposal at 21098-21099.

[21] 17 C.F.R. §§ 43.3(e)(3), 43.3(e)(4), 45.14(a).

[22] Proposal at 21098-21099. Proposed §§ 43.3(e)(1)(i) and 45.14(b)(1)(i) address the timing for errors and corrections.

[23] Proposal at 21098-21099. Proposed §§ 43.3(e)(1)(ii) and 45.14(b)(1)(ii) address the requirement to notify the Director of the Division of Market Oversight if the error correction timing cannot be met.

[24] Proposal at 21098-21099.

[25] Proposal at 21098-21099. The Proposal makes clear that the non-reporting counterparty is not only responsible for notifying the reporting counterparty of errors or omissions in the data that is reported, but also to notify the reporting counterparty of data that was not reported to an SDR.

[26] Proposal at 21099-21099. Proposed §§ 43.3(e)(2) and 45.14(b)(2) would also require that if the reporting counterparty, SEF or DCM, as applicable, and the non-reporting counterparty agree that the swap data for a swap is incorrect or incomplete, the reporting counterparty, SEF or DCM, as applicable, must correct the swap data in accordance with proposed § 43.3(e)(1) or § 45.14(b)(1), as applicable.

[27] *See* 17 C.F.R. §§ 23.204(a), 23.205(a).

[28] *See* 17 C.F.R. §§ 23.204(b), 23.205(b).

[29] Proposal at 21097.

[30] With respect to Part 45, the Proposal explains that such policies and procedures would include, but not be limited to: (i) the reporting process and designation of responsibility for reporting swap data, (ii) reporting system outages or malfunctions (including the use of back-up systems), (iii) verification of

all swap data reported to an SDR, (iv) training programs for employees responsible for reporting under Part 45, (v) control procedures relating to reporting under Part 45 and designation of personnel responsible for testing and verifying such policies and procedures; and (vi) reviewing and assessing the performance and operational capability of any third party that carries out any duty required by Part 45 on behalf of the SD or MSP as well as any rules established by the SDR. With respect to Part 43, the Proposal explains that such policies and procedures would include, but not be limited to: (i) the reporting process and designation of responsibility for reporting swap transaction and pricing data, (ii) reporting system outages or malfunctions (including use of back-up systems), (iii) training programs for employees responsible for reporting under Part 43, (iv) control procedures relating to reporting under Part 43 and designation of personnel responsible for testing and verifying such policies and procedures, (v) reviewing and assessing the performance and operational capability of any third party that carries out any duty required by Part 43 on behalf of the SD or MSP; and (vi) the determination of whether a new swap transaction or amendment, cancelation, novation, termination, or other lifecycle event of an existing swap, is subject to the real-time reporting requirements under Part 43. Proposal at 21073.

[31] Proposal at 21097.

[32] *See, e.g.*, 17 C.F.R. § 3.3(d)(1) (requiring a chief compliance officer to administer each of the registrant's policies and procedures relating to its business as an SD/MSP that are required to be established pursuant to the Act and the Commission's regulations); 17 CFR § 3.2(c)(3)(ii) (requiring the National Futures Association to assess whether an entity's SD/MSP documentation demonstrates compliance with the Section 4s Implementing Regulation to which it pertains which includes § 23.204 and § 23.205).



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