

System, which describes the application procedure.

### The Proposal

The FAA is considering an amendment to Title 14, Code of Federal Regulations (14 CFR) part 71 to establish Class E airspace at Wolfeboro, NH providing the controlled airspace required to support the new Copter RNAV GPS special standard instrument approach procedures for Huggins Hospital Heliport. Controlled airspace extending upward from 700 feet above the surface is required for IFR operations within a 6-mile radius of the point in space coordinates for the heliport.

Class E airspace designations are published in Paragraph 6005 of FAA order 7400.9U, dated August 18, 2010, and effective September 15, 2010, which is incorporated by reference in 14 CFR 71.1. The Class E airspace designation listed in this document will be published subsequently in the Order.

The FAA has determined that this proposed regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It, therefore, (1) is not a "significant regulatory action" under Executive Order 12866; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a Regulatory Evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this proposed rule, when promulgated, would not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

The FAA's authority to issue rules regarding aviation safety is found in Title 49 of the United States Code. Subtitle I, section 106 describes the authority of the FAA Administrator. Subtitle VII, Aviation Programs, describes in more detail the scope of the agency's authority. This proposed rulemaking is promulgated under the authority described in subtitle VII, part A, subpart I, section 40103. Under that section, the FAA is charged with prescribing regulations to assign the use of airspace necessary to ensure the safety of aircraft and the efficient use of airspace. This proposed regulation is within the scope of that authority as it would establish Class E airspace at Huggins Hospital, Wolfeboro, NH.

### List of Subjects in 14 CFR Part 71:

Airspace, Incorporation by reference, Navigation (Air).

### The Proposed Amendment

In consideration of the foregoing, the Federal Aviation Administration proposes to amend 14 CFR part 71 as follows:

#### **PART 71—DESIGNATION OF CLASS A, B, C, D, AND CLASS E AIRSPACE AREAS; AIR TRAFFIC SERVICE ROUTES; AND REPORTING POINTS**

1. The authority citation for part 71 continues to read as follows:

**Authority:** 49 U.S.C. 106(g); 40103, 40113, 40120; E.O. 10854, 24 FR 9565, 3 CFR, 1959–1963 Comp., p. 389.

#### **§ 71.1 [Amended]**

2. The incorporation by reference in 14 CFR 71.1 of Federal Aviation Administration Order 7400.9U, Airspace Designations and Reporting Points, dated August 18, 2010, effective September 15, 2010, is amended as follows:

*Paragraph 6005 Class E Airspace Areas Extending Upward from 700 Feet or More Above the Surface of the Earth.*

\* \* \* \* \*

#### **ANE NH E5 Wolfeboro, NH [New]**

Huggins Hospital Heliport, NH  
(Lat. 43°34'56" N., long. 71°12'06" W.)  
Point in Space Coordinates  
(Lat. 43°35'15" N., long. 71°11'19" W.)

That airspace extending upward from 700 feet above the surface within a 6-mile radius of the Point in Space Coordinates (lat. 43°35'15" N., long. 71°11'19" W.) serving the Huggins Hospital Heliport.

Issued in College Park, Georgia, on December 13, 2010.

**Mark D. Ward,**

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### **COMMODITY FUTURES TRADING COMMISSION**

#### **17 CFR Part 23**

**RIN 3038–AC96**

#### **Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Commodity Futures Trading Commission (Commission or

CFTC) is proposing regulations to implement new statutory provisions established under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Section 731 of the Dodd-Frank Act added a new section 4s(i) to the Commodity Exchange Act (CEA), which requires the Commission to prescribe standards for swap dealers and major swap participants related to the timely and accurate confirmation, processing, netting, documentation, and valuation of swaps. The proposed rules would establish requirements for swap confirmation, portfolio reconciliation, and portfolio compression for swap dealers and major swap participants. **DATES:** Submit comments on or before February 28, 2011.

**ADDRESSES:** You may submit comments, identified by RIN number 3038–AC96 and Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, by any of the following methods:

- Agency Web site, via its Comments Online process at <http://comments.cftc.gov>. Follow the instructions for submitting comments through the Web site.

- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

- *Hand Delivery/Courier:* Same as mail above.

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments. Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that may be exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the established procedures in § 145.9 of the Commission's regulations, 17 CFR 145.9.

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <http://www.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted

or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

**FOR FURTHER INFORMATION CONTACT:**

Sarah E. Josephson, Associate Director, 202-418-5684, [sjosephson@cftc.gov](mailto:sjosephson@cftc.gov); Frank N. Fisanich, Special Counsel, 202-418-5949, [ffisanich@cftc.gov](mailto:ffisanich@cftc.gov); or Jocelyn Partridge, Special Counsel, 202-418-5926, [jpartridge@cftc.gov](mailto:jpartridge@cftc.gov); Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

**SUPPLEMENTARY INFORMATION:**

**I. Background**

On July 21, 2010, President Obama signed the Dodd-Frank Act.<sup>1</sup> Title VII of the Dodd-Frank Act<sup>2</sup> amended the Commodity Exchange Act (CEA)<sup>3</sup> to establish a comprehensive regulatory framework to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to all registered entities and intermediaries subject to the Commission's oversight.

Section 731 of the Dodd-Frank Act amends the CEA by adding a new Section 4s, which sets forth a number of requirements for swap dealers and major swap participants. Specifically, section 4s(i) of the CEA establishes swap documentation standards for those registrants.

Section 4s(i)(1) requires swap dealers and major swap participants to "conform with such standards as may be prescribed by the Commission by rule or regulation that relate to timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps." Under section 4s(i)(2), the Commission is required to adopt rules

"governing documentation standards for swap dealers and major swap participants." The Commission is proposing the regulations on swap confirmation, portfolio reconciliation, and portfolio compression<sup>4</sup> discussed below, pursuant to the authority granted under sections 4s(h)(1)(D), 4s(h)(3)(D), 4s(i), and 8a(5) of the CEA.<sup>5</sup> The Dodd-Frank Act requires the Commission to promulgate these provisions by July 15, 2011.

The proposed regulations reflect consultation with staff of the following agencies: (i) The Securities and Exchange Commission; (ii) the Board of Governors of the Federal Reserve System; (iii) the Office of the Comptroller of the Currency; and (iv) the Federal Deposit Insurance Corporation. Staff from each of these agencies has had the opportunity to provide oral and/or written comments to the proposal, and the proposed regulations incorporate elements of the comments provided.

**II. Proposed Regulations**

The proposed regulations would prescribe standards for the timely and accurate confirmation of swaps and would require the reconciliation and compression of swap portfolios. Confirmation, portfolio reconciliation, and portfolio compression have been recognized as important post-trade processing mechanisms for reducing risk and improving operational efficiency by both current market participants and their regulators.

With respect to confirmation, prudent practice requires that, after coming to an agreement on the terms of a transaction, parties document the transaction in a complete and definitive written record so there is legal certainty about the terms of their agreement. Through portfolio reconciliation, counterparties are able to resolve any discrepancies or disputes as early as possible and arrive at an understanding of their overall risk exposure to one another. Portfolio compression allows for a reduction in outstanding trade count and outstanding gross notional value by replacing redundant trades with a smaller number of trades and reduced gross notional value. This process reduces operational risk and increases operational efficiency because there are fewer trades to

maintain, and results in a more accurate expression of market size.

In the past few years, market participants and regulators have paid particular attention to the post-trade processing of swaps. For example, operational issues associated with the over-the-counter (OTC) derivatives market have been the focus of reports and recommendations by the President's Working Group on Financial Markets (PWG).<sup>6</sup> In response to the financial crisis in 2008, the PWG called on the industry to improve trade matching and confirmation and to promote portfolio reconciliation.

Since 2005, the Federal Reserve Bank of New York (FRBNY) has led a targeted, supervisory effort to enhance operational efficiency and performance in the OTC derivatives market, by increasing automation in processing and by promoting the timely confirmation of trades. Known as the OTC Derivatives Supervisors' Group (ODSG), the FRBNY leads an on-going effort with OTC derivatives dealers' primary supervisors, trade associations, industry utilities, and private vendors, through which market participants (including buy-side participants) regularly set goals and commitments to bring infrastructure, market design, and risk management improvements to all OTC derivatives asset classes. Over the years, the ODSG has expanded its focus from credit derivatives to include interest rate derivatives, equity derivatives, foreign exchange derivatives, and commodity derivatives. Along with this expanded focus has come increased engagement with market participants on cross-asset class issues. Specifically, the ODSG encouraged the industry to commit itself to a number of reforms, including improved operational performance with respect to the OTC derivatives confirmation process, portfolio reconciliation, and portfolio compression. The regulations proposed by the Commission would build upon the ODSG's work.

It is important to note at the outset, that the Commission expects that swap dealers and major swap participants would be able to comply with each of the proposed rules by executing a swap on a swap execution facility (SEF) or on a designated contract market (DCM), or by clearing the swap through a derivatives clearing organization (DCO). For swaps executed on a SEF or a DCM, the SEF or DCM will provide the counterparties with a definitive written

<sup>1</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at <http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

<sup>2</sup> Pursuant to Section 701 of the Dodd-Frank Act, Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010."

<sup>3</sup> 7 U.S.C. 1 et seq.

<sup>4</sup> The Commission may propose additional rules related to documentation provisions under section 4s(i) of the CEA.

<sup>5</sup> Section 8a(5) of the CEA authorizes the Commission to promulgate such regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the CEA.

<sup>6</sup> See, e.g., Press Release, "President's Working Group on Financial Markets, Progress Summary on OTC Derivatives Operational Improvements" (Nov. 2008).

record of the terms of their agreement, which will serve as a confirmation of the swap. Similarly, if a swap is executed bilaterally, but subsequently submitted to a DCO for clearing, the DCO will require a definitive written record of all terms to the counterparties' agreement prior to novation by the DCO; this too would serve as a confirmation of the swap.

When a swap is cleared by a central counterparty, the problems that portfolio reconciliation is designed to solve (agreement on all terms and the valuation of the swap) no longer exist because the clearinghouse (1) requires a definitive written record of all terms of the swap; and (2) arrives at a settlement price for all cleared swaps on a daily basis. Additionally, the Commission is considering a proposed regulation that would require DCOs to offer portfolio compression exercises on a regular basis. The proposed rule for swap dealers and major swap participants has been designed to complement the proposed DCO rule.

In designing these rules, the Commission has taken care to minimize the burden on those parties that will not be registered with the Commission as swap dealers or major swap participants. To the extent that market participants believe that additional measures should be taken to reduce the burden or increase the benefits of confirmation, reconciliation, and compression for the swaps market, the Commission welcomes all comments.

The Commission requests comment on all aspects of proposed §§ 23.500 (definitions), 23.501 (confirmation), 23.502 (portfolio reconciliation), and 23.503 (portfolio compression), as well as comment on the specific provisions and issues highlighted in the discussion below. The Commission further requests comment on an appropriate effective date for final regulations, including comment on whether it would be appropriate to have staggered or delayed effective dates for some regulations based on the nature or characteristics of the activities or entities to which they apply. The Commission recognizes that there will be differences in the size and scope of the business of particular swap dealers and major swap participants. Therefore, comments are solicited on whether certain provisions of the proposed regulations should be modified or adjusted to reflect the differences among swap dealers and major swap participants or differences among asset classes.

### A. Swap Confirmation

#### 1. Background

Over the past several years, OTC derivatives market participants and their regulators have paid particular attention to the timely confirmation of swaps. The Government Accountability Office (GAO) found that the rapid expansion of trading volume of swaps, such as credit derivatives since 2002, caused stresses on the operational infrastructure of market participants. These stresses in turn caused the participants' back office systems to fail to confirm the increased volume of trades for a period of time.<sup>7</sup> The GAO found that the lack of automation in trade processing and the purported assignment of positions by transferring parties to third parties without notice to their counterparties were factors contributing to this backlog. If transactions, whether newly executed or recently transferred to another party, are left unconfirmed, there is no definitive written record of the contract terms. Thus, in the event of a dispute, the terms of the agreement must be reconstructed from other evidence, such as e-mail trails or recorded trader conversations. This process is cumbersome and may not be wholly accurate. Moreover, if purported transfers of swaps, in whole or in part, are made without giving notice to the remaining parties and obtaining their consent, disputes may arise as to which parties are entitled to the benefits and subject to the burdens of the transaction.

As the work of the ODSG demonstrates, the industry is capable of swift movement to contemporaneous execution and confirmation. A large back-log of unexecuted confirmations in the credit default swap (CDS) market created by prolonged negotiations and inadequate confirmation procedures were the subject of the first industry commitments made by participating dealers to ODSG.<sup>8</sup> In October 2005, the participating dealers committed to reduce by 30% the number of confirmations outstanding more than 30 days within four months. In March 2006, the dealers committed to reduce the number of outstanding confirmations by 70% by June 30, 2006. By September 2006, the industry had reduced the number of all outstanding

CDS confirmations by 70%, and the number of CDS confirmations outstanding more than 30 days by 85%. The industry achieved these targets largely by moving 80% of total trade volume in CDS to confirmation on electronic platforms, eliminating backlogs in new trades. Today, over 90% of "electronically eligible"<sup>9</sup> CDS trades are confirmed electronically, the majority on the day of execution and up to 98% within two days.<sup>10</sup>

The ODSG has established a supervisory goal for all transactions to be confirmed as soon as possible after the time of execution. Ideally, this would mean that there would be a written or electronic document executed by the parties to a swap for the purpose of evidencing all of the terms of the swap, including the terms of any termination (prior to its scheduled maturity date), assignment, novation, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations.

In the case of electronically processed transactions, all such transactions should be matched and confirmed, at a minimum, on the same day the trade was executed. For electronically processed transactions, confirmation typically is effected by a third-party "matching" process. If transactions are not confirmed in a timely manner, backlogs of outstanding unconfirmed trades develop, increasing risk. Timely and accurate confirmation of transactions is critical for all downstream operational and risk management processes, including the correct calculation of cash flows and discharge of settlement obligations as well as accurate measurement of counterparty credit exposures. Timely confirmation also allows any rejections, exceptions, and/or discrepancies to be identified and resolved more quickly.

Another ODSG objective is a marketplace that electronically processes as many transactions as possible in as many parts of the processing life cycle as possible, but particularly in the "upstream" parts of the life cycle, where transaction information is first entered into the system (trade capture). To achieve this objective, as many transactions as possible and practicable should be executed on electronic platforms, such

<sup>7</sup> U.S. Government Accountability Office, "Credit Derivatives: Confirmation Backlogs Increased Dealers' Operational Risks, But Were Successfully Addressed After Joint Regulatory Action," GAO-07-716 (2007) at pages 3-4.

<sup>8</sup> See October 4, 2005 industry commitment letter to the Federal Reserve Bank of New York, available at [http://www.newyorkfed.org/newsevents/news\\_archive/markets/2005/an050915.html](http://www.newyorkfed.org/newsevents/news_archive/markets/2005/an050915.html).

<sup>9</sup> It remains unclear precisely how much of the total CDS market is not "electronically eligible," as eligibility is determined by the OTC derivatives market participants.

<sup>10</sup> See March 1, 2010 Summary of OTC Derivatives Commitments provided to the Federal Reserve Bank of New York, available at [http://www.newyorkfed.org/newsevents/news/markets/2010/100301\\_table.pdf](http://www.newyorkfed.org/newsevents/news/markets/2010/100301_table.pdf).

as SEFs, in order to approach the ideal of “straight-through processing.” Otherwise, transactions should be keyed into electronic systems as soon as possible after execution.

## 2. Proposed Confirmation Rule

To promote the efficient operation of the swap market, and to facilitate market participants’ overall risk management, the Commission is proposing confirmation § 23.501.

For the purposes of proposed § 23.501, proposed § 23.500 would provide certain critical definitions pertaining to confirmation. An acknowledgment would be defined as a written or electronic record of all the terms of a swap signed and sent by one party to another. When one party acknowledges the terms of a swap and its counterparty verifies it, the result is the issuance of a confirmation that reflects the terms of the swap between the parties. A confirmation thus would be defined as a written or electronic record of a swap that has been signed and sent by one party and verified by the other where that record has been manually, electronically, or by some other legally equivalent means, signed by the receiving counterparty. Finally, proposed § 23.500 would define execution to be a legally-binding oral, written, or electronic agreement by the parties. For the purposes of the confirmation rule, the term swap transaction is defined to include any event that would result in a new swap or a change in the terms of a swap, including execution, termination, assignment, novation, exchange, transfer, amendment, conveyance, or extinguishing of rights or obligations under a swap.

With regard to both acknowledgments and confirmations, the Commission intends that all the terms of a swap transaction be provided for acknowledgment and confirmation. The objective is that parties have full written agreement on all terms as soon as practicable after execution and also upon any ownership event during the life of the swap. Such life cycle events would include any termination (prior to the scheduled maturity date of the swap), assignment, novation, exchange, transfer, amendment, or conveyance of, or extinguishing of rights or obligations under the swap.<sup>11</sup> For each of these events, the parties should have written documentation evidencing all the terms of the transaction, as soon as possible

<sup>11</sup> Life cycle events would also include corporate actions affecting a security or securities on which the swap is based (e.g., a merger, dividend, stock split or bankruptcy).

after the transaction occurs. This approach to documenting “life cycle event data” is consistent with the Commission’s proposed rules for reporting swap data to a swap data repository.<sup>12</sup>

The timely and accurate confirmation of all swaps and life cycle events for existing swaps would ensure that the parties know the terms of their executed transactions and the identities of their counterparties at all times. Confirming all swap transactions on the day of execution should be standard for all market participants. However, the Commission recognizes some entities that will not be registered as swap dealers or major swap participants may not have the operational capacity to confirm their swap transactions as quickly as swap dealers and major swap participants. Accordingly, the Commission is proposing a bifurcated approach for confirmations. Swap dealers and major swap participants entering into swap transactions with other swap dealers or major swap participants would be required to obtain a confirmation on the same calendar day as execution (*i.e.*, no later than T+0).

On the other hand, swap dealers and major swap participants entering into swap transactions with counterparties that are not swap dealers or major swap participants would be required to send an acknowledgment for each swap on the same calendar day as execution (*i.e.*, no later than T+0). Swap dealers and major swap participants would then have policies and procedures in place to confirm the swap with financial entities as defined in proposed § 23.500<sup>13</sup> on the same calendar day as execution and with all other entities not later than the next business day following execution.

The Commission also is proposing that the times prescribed for achieving

<sup>12</sup> The Notice of Proposed Rulemaking for Swap Data Recordkeeping and Reporting Requirements is available on the Commission’s Web site: <http://comments.cftc.gov/FederalRegister/Proposed.aspx>.

<sup>13</sup> This definition is taken from the end user exception to the clearing requirement under section 2(h)(7)(C)(i) of the CEA. The term financial entity includes the following eight entities: (i) A swap dealer; (ii) a security-based swap dealer; (iii) a major swap participant; (iv) a major security-based swap participant; (v) a commodity pool as defined in section 1a(10) of the CEA; (vi) a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80-b-2(a)); (vii) an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002); or (viii) a person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956. See 7 U.S.C. 2(h)(7)(C)(i). The definition would include the statutory exclusion and limitation as contained in section 2(h)(7)(C) and also would include any Commission regulations promulgated pursuant to the statutory section.

swap acknowledgment and confirmation vary depending upon whether transactions are electronically executed or electronically processed. Under proposed § 23.501(a)(1), all swap dealers and major swap participants entering into swap transactions with other swap dealers or major swap participants would be required to confirm their swap transactions according to the following timeframe:

- For any swap transaction that has been executed and processed electronically, within 15 minutes of execution;
- For any swap transaction that is not electronically executed, but that will be processed electronically, within 30 minutes of execution; or
- For any swap transaction that cannot be processed electronically by the swap dealer or major swap participant, within the same calendar day as execution.

Under proposed § 23.501(a)(2), swap dealers and major swap participants entering into swap transactions with counterparties that are not swap dealers or major swap participants would be required to send an acknowledgment of each swap transaction according to the following timeframe:

- For any swap transaction that has been executed and processed electronically, within 15 minutes of execution;
- For any swap transaction that is not executed electronically, but that will be processed electronically, within 30 minutes after execution; or
- For any swap transaction that cannot be processed electronically by the swap dealer or major swap participant, within the same calendar day as execution.

For those swap transactions entered into with counterparties that are not swap dealers or major swap participants, under proposed § 23.501(a)(3), swap dealers and major swap participants would be required to establish written policies and procedures reasonably designed to ensure confirmation with financial entities on the same calendar day as execution and with all other entities by the next business day after the swap transaction is executed. These procedures must include a requirement that, prior to entering into any swap transaction, the swap dealer or major swap participant furnish to a prospective counterparty, or receive from a prospective counterparty, a draft acknowledgment specifying all terms of the swap transaction other than pricing and terms to be definitively agreed to at execution. As is currently the custom in many swap markets, including credit

and equity derivative markets, the parties may rely on a standard confirmation agreement.

Under proposed § 23.501(b), a swap dealer or major swap participant would be required to keep records regarding the processing of swap acknowledgments and confirmations. These records would include the time and date of transmission or receipt of any acknowledgment or confirmation, the length of time between transmission of any acknowledgment to a counterparty and receipt of the signed confirmation, and the length of time between execution and confirmation of the swap.

In order to retain flexibility for all market participants, the proposed rules do not prescribe a particular venue or platform for confirmation. As noted above, currently many swap transactions are electronically processed by third-party "matching" services. While the Commission encourages the continued use and expansion of these services, the approach taken in the proposed rule would allow parties the ability to confirm bilaterally through whatever means they select, so long as they are able to meet the schedule laid out in the rule.

In a similar effort to retain flexibility, at this time, the Commission is not prescribing the acknowledgment or confirmation documentation that market participants must use. The Commission encourages the use of master confirmation agreements and other standardized documentation that has been developed by the industry in an effort to reduce confirmation backlogs, among other things. However, the most critical aspect of the confirmation rule is that all the terms of the swap are agreed to in writing and in a timely manner.

The proposed rules would apply to all new swaps and to all swap transactions, as that term is defined in the rules, entered into after the effective date of the regulation.

### 3. Comments Requested

The Commission requests comment on all aspects of proposed § 23.501. In particular, the Commission requests comment on the following questions:

- Does the proposed rule appropriately allocate the responsibility for providing the swap acknowledgments?
- Is it feasible to require that all acknowledgments be provided electronically?
- Should the proposed rule require swap dealers and major swap participants to provide a swap acknowledgment or confirmation more

quickly, particularly for transactions that are executed or processed electronically?

- Does the proposed rule provide sufficient time for swap dealers and major swap participants to provide swap acknowledgments to their counterparties?
  - Are there swap transactions for which all of the terms required to be included on an acknowledgment or in a confirmation would not be known on the same calendar day as execution? If so, please describe these swap transactions and include the terms that would not be known on the same calendar day as execution, as well as the reason these terms would not be known.
  - Is it necessary to clarify further that the confirmation rule would apply to life cycle events, such as termination, assignment, novation, exchange, transfer, amendment, or conveyance?
  - Are there other post-execution events for which a confirmation should be executed?
  - Should counterparties be permitted to agree expressly that certain life cycle events (such as assignment of payable rights), do not require subsequent confirmations? Are there life cycle events that can be carved out of the rule while still achieving the purpose of the rule? Should more time be permitted for confirmation of certain life cycle events, such as transfers resulting from a merger, consolidation, or transfer of all assets to another entity?
  - Should the Commission require that electronic matching services or confirmation platforms be used where reasonably practicable?
  - Does the term "processed electronically" require more clarification? If so, what definition would be effective and flexible enough to accommodate future market innovation?
  - Should the Commission require that all swaps be processed electronically?
  - Are there circumstances where swap dealers and major swap participants have the ability to process a transaction electronically, but should not be required to do so?
  - Has the Commission properly accounted for current industry practice with respect to the time necessary to confirm swap transactions?
  - Would the proposed rule unduly restrict the types of swaps that swap dealers and major swap participants may enter into or the persons that may be their counterparties?
  - Should executing a swap on a SEF or DCM be deemed to satisfy the confirmation requirement?

- Should clearing a swap through a DCO be deemed to satisfy the confirmation requirement?
- Should the terms calendar day and business day be further defined and has the rule properly accounted for counterparties in different time zones executing swaps?

### B. Swap Portfolio Reconciliation

#### 1. Background

Section 4s(i) of the CEA directs the Commission to prescribe regulations for the timely and accurate confirmation, processing, documentation, and valuation of all swaps entered into by swap dealers and major swap participants. Disputes related to confirming the terms of a swap, as well as swap valuation disputes,<sup>14</sup> have long been recognized as a significant problem in the OTC derivatives market. Portfolio reconciliation is considered an effective means of identifying and resolving these disputes. Specifically, portfolio reconciliation is a post-execution processing and risk management technique that is designed to:

- (1) Identify and resolve discrepancies between the counterparties with regard to the terms of a swap either immediately after execution or during the life of the swap;
- (2) ensure effective confirmation of all the terms of the swap; and
- (3) identify and resolve discrepancies between the counterparties regarding the valuation of the swap. In some instances, portfolio reconciliation also may facilitate the identification and resolution of discrepancies between the counterparties with regard to valuations of collateral held as margin.

The Commission recognizes that the industry has made significant progress in adopting the use of portfolio reconciliation to decrease the number of swap disputes.<sup>15</sup> In December 2008, the ODSG's group of 14 major dealers committed to execute daily portfolio reconciliations for collateralized portfolios in excess of 500 trades between participating dealers by June of 2009.<sup>16</sup> As of May 2009, all participating dealers were satisfying this commitment. In October 2009, the

<sup>14</sup> See ISDA Collateral Committee, "Commentary to the Outline of the 2009 ISDA Protocol for Resolution of Disputed Collateral Calls," June 2, 2009 (stating "Disputed margin calls have increased significantly since late 2007, and especially during 2008 have been the driver of large (sometimes > \$1 billion) un-collateralized exposures between professional firms.").

<sup>15</sup> The Commission also recognizes and encourages the industry practice of immediately transferring undisputed collateral amounts.

<sup>16</sup> See June 2, 2009 summary of industry commitments, available at [http://www.isda.org/c\\_and\\_a/pdf/060209table.pdf](http://www.isda.org/c_and_a/pdf/060209table.pdf).

ODSG committed to publishing a feasibility study on market-wide portfolio reconciliation that would set forth how regular portfolio reconciliation could be extended beyond the ODSG dealers to include smaller banks, buy-side participants, and derivative end users. Consistent with this publication, the ODSG dealers expanded their portfolio reconciliation commitment in March 2010 to include monthly reconciliation of collateralized portfolios in excess of 1,000 trades with any counterparty. Most recently, the industry has been preparing a new "Convention on the Investigation of Disputed Margin Calls" and a new "Formal Market Polling Procedure" that are intended to "create a consistent and predictable process \* \* \* that eliminates present uncertainties and delays."<sup>17</sup>

Accordingly, the Commission is proposing § 23.502, which would require swap dealers and major swap participants to reconcile their portfolios with one another and provide counterparties who are not registered as swap dealers or major swap participants with regular opportunities for portfolio reconciliation. In order for the marketplace to realize the full risk reduction benefits of portfolio reconciliation, the Commission is proposing to expand portfolio reconciliation to all transactions, whether collateralized or uncollateralized. For the swap market to operate efficiently and to reduce systemic risk, portfolio reconciliation should be a proactive process that delivers a consolidated view of counterparty exposure down to the transaction level. By identifying and managing mismatches in key economic terms and valuation for individual transactions across an entire portfolio, overall risk can be identified and reduced.

## 2. Proposed Portfolio Reconciliation Rule

For the purposes of proposed § 23.502, swap portfolio reconciliation would be defined in proposed § 23.500 as a process by which the two parties to one or more swaps: (1) Exchange the terms of all swaps in the portfolio between the parties; (2) exchange each party's valuation of each swap in a portfolio between the parties as of the close of business on the immediately preceding business day; and (3) resolve any discrepancy in material terms and valuations. Valuation would be defined

in proposed § 23.500 as the current market value or net present value of a swap, and material terms would be defined as all terms of a swap required to be reported in accordance with part 45 of this chapter.

Proposed § 23.502(a) would require swap dealers and major swap participants to reconcile swap portfolios with other swap dealers or major swap participants with the following frequency: Daily for portfolios consisting of 300 or more swaps, at least weekly for portfolios consisting of 50 to 300 swaps, and at least quarterly for portfolios consisting of fewer than 50 swaps. Swap dealers and major swap participants would be required to resolve immediately any discrepancy in a material term identified as part of a portfolio reconciliation process. The Commission is proposing an immediate resolution requirement for material terms for the same reasons that necessitate timely confirmation—parties need to know the terms of their executed agreements with one another. A discrepancy in the terms of a swap likely indicates that the parties have failed to confirm the swap in accordance with Commission regulations, and, therefore, the parties should take immediate action to resolve the discrepancy. This requirement would support and ensure compliance with proposed § 23.501, which requires a confirmation of all terms of a swap.

The Commission believes that requiring reconciliation of all swap portfolios among swap dealers and major swap participants (rather than only collateralized portfolios, as contemplated by the ODSG work) is appropriate because CEA section 4s(e) requires that swap dealers and major swap participants will be subject to minimum capital and margin requirements. As a result, the Commission anticipates that most, if not all, swaps entered by swap dealers and major swap participants will be subject to some form of collateralization. The Commission also believes that requiring more frequent reconciliation of smaller portfolios is appropriate because section 2(a)(13)(G) of the CEA requires all swaps to be reported to a registered swap data repository, and, therefore, the Commission anticipates that swap dealers and major swap participants will be able to efficiently reconcile their internal records with their counterparties electronically by reference to data in the repositories. The threshold of 300 swaps for daily reconciliation is intended to capture swap portfolios where there is a high likelihood that the swap dealer or major swap participant's counterparty will

have the technological capacity to perform reconciliation processes electronically.

Under proposed § 23.502(a)(5), swap dealers and major swap participants would be required to resolve any discrepancy in a valuation identified as part of a portfolio reconciliation process within one business day. The Commission recognizes that there may be reasonable grounds for some variation in the calculation of swap valuation at any given time. Consequently, the proposed rule would not require that swap dealers and major swap participants expend resources to resolve all discrepancies in the valuation of the swap, but only if the difference between the lower valuation and the higher is greater than 10%.

In addition, given that there are a number of services and industry-led initiatives that may facilitate resolution of valuation disputes, at this time the Commission is not proposing to mandate that swap dealers and major swap participants implement any specific procedure for resolution of a discrepancy in the valuation of a swap. Rather, it is only proposing a deadline for dispute resolution of one business day following discovery of such discrepancy.

For swap portfolios with entities other than swap dealers or major swap participants, proposed § 23.502(b) would require swap dealers and major swap participants to establish written policies and procedures to perform reconciliation, but would not prescribe the manner in which the reconciliation must be performed. For example, the exchange of terms and valuations between the counterparties may consist of one party reviewing the details and valuations delivered by the other party and either affirming or objecting to such details and valuations. The frequency parameters of portfolio reconciliation would be similar to those for swap portfolios between swap dealers or major swap participants.<sup>18</sup> There are some important distinctions in the proposed treatment of swap portfolios between a swap dealer or major swap participant and others that promote flexibility for those entities that will not be registered with the Commission. Swap dealers and major swap participants would be required simply to establish written procedures reasonably designed to resolve any discrepancies in the material terms or valuation of each swap identified as part

<sup>17</sup> See "ISDA 2010 Convention on the Investigation of Disputed Margin Calls" and "ISDA 2010 Formal Market Polling Procedure."

<sup>18</sup> The frequency thresholds are similar: Daily for portfolios consisting of 500 or more swaps, at least weekly for portfolios consisting of 100–500 swaps, and at least quarterly for portfolios consisting of less than 100 swaps.

of a portfolio reconciliation process in a timely fashion. Again, differences in valuation of a swap need not be deemed a discrepancy unless the difference between the lower valuation and the higher valuation is greater than 10% of the higher valuation.

Proposed § 23.502(c) would create a safe harbor for cleared swaps because portfolio reconciliation is needed primarily for uncleared swaps. When swaps are cleared, the clearinghouse requires that each swap be matched prior to novation by the clearinghouse. Moreover, once cleared, clearinghouses determine daily settlement prices, which preclude any valuation disputes.

The proposed rule would apply to all swaps within a swap portfolio as of the effective date of the regulation.

Finally, proposed § 23.502(d) would require that swap dealers and major swap participants maintain records of each discrepancy identified during portfolio reconciliation and the length of time taken to resolve that discrepancy.

### 3. Comments Requested

The Commission requests comment on all aspects of proposed § 23.502(d). In particular, the Commission requests comment on the following questions:

- Are the proposed deadlines for swap portfolio discrepancy resolution in the proposed regulation appropriate?

- Are the reconciliation thresholds and frequency requirements appropriate?

- Are swap dealers and major swap participants likely to have a large number of counterparties with whom they would be required to perform daily reconciliation that do not have the technological capacity to perform reconciliation processes electronically?

- Is the proposal that a valuation difference of less than 10% not be deemed to be a discrepancy appropriate? If not, please provide a suggested valuation discrepancy threshold.

- Should the proposed rule include a provision that requires discrepancy resolution if the aggregate of valuation differences of less than 10% across a portfolio exceeds a certain threshold? If so, please provide a suggested threshold.

- How would the requirement to resolve valuation discrepancies in one day for swaps among swap dealers and major swap participants affect the very detailed and complex industry initiatives currently being considered for resolving valuation disputes?

- Should all terms of a swap transaction be reconciled or just the key economic terms?

- Should all discrepancies in swap transaction terms be resolved or just the material ones?

- Should the definition of material terms be clarified?

- Should financial entities as defined in proposed § 23.500 be required to participate in portfolio reconciliation under proposed § 23.502(a)?

### C. Portfolio Compression

#### 1. Background

Section 4s(i) of the CEA directs the Commission to prescribe regulations for the timely and accurate processing and netting of all swaps entered into by swap dealers and major swap participants. Portfolio compression is an important, post-trade processing and netting mechanism that can be an effective and efficient tool for the timely and accurate processing and netting of swaps by market participants. Accordingly, the Commission is proposing § 23.503, which would require swap dealers and major swap participants to engage in certain bilateral and multilateral portfolio compression exercises.

Portfolio compression is a mechanism whereby substantially similar transactions among two or more counterparties are terminated and replaced with a smaller number of transactions of decreased notional value in an effort to reduce the risk, cost, and inefficiency of maintaining unnecessary transactions on the counterparties' books. In many cases, these redundant or economically-equivalent positions serve no useful business purpose, but can create unnecessary risk,<sup>19</sup> as well as operational and capital inefficiencies. In a portfolio compression exercise, swap market participants whose combined portfolios include outstanding transactions that contain substantially similar economic terms and/or that would result in redundant payments wholly or partially net their swaps by terminating the original swaps and replacing them with a smaller number of new transactions that have a lower gross notional value.

Market vendors assert that as many as 40,000 trades can be terminated in a single portfolio compression cycle.<sup>20</sup> Because portfolio compression participants are permitted to establish their own credit, market, and cash payment risk tolerances and to establish their own mark-to-market values for the transactions to be compressed, the

process does not alter the risk profiles of the individual participants beyond a level acceptable to the participant.

Portfolio compression exercises can be performed on a bilateral or multilateral basis. Multilateral compression exercises are preferable because the larger number of participants significantly increases the number of trades that can be eliminated and removes the need for bilateral negotiation between counterparties. In a multilateral portfolio compression exercise, the replacement swaps may be with the same or different counterparties.

The benefits of portfolio compression to both individual market participants and to the market as a whole are considerable. The reduced transaction count decreases operational risk generally as there are fewer trades to maintain, process, and settle.<sup>21</sup> The reduction in the outstanding gross notional value of the swaps also allows for increased capital liquidity and efficiency. Firms can set aside less capital for their positions while maintaining their desired risk positions in the market. The diminished operational risk for the individual market participants achieved by portfolio compression, in turn, may lessen systemic risk and enhance the overall stability of the financial markets. Compression also may provide a more accurate expression of overall market size and composition, and provide market participants with a more precise picture of their exposures.

The usefulness of portfolio compression as a risk management tool has been acknowledged widely. In 2008, the PWG identified frequent portfolio compression of outstanding trades as a key policy objective in the effort to strengthen the OTC derivatives market infrastructure.<sup>22</sup> Similarly, the 2010 staff report outlining policy perspectives on OTC derivatives infrastructure issued by the FRBNY identified trade compression as an element of strong risk management and recommended that market participants engage in regular, market-wide portfolio compression exercises.<sup>23</sup>

The value of portfolio compression also is illustrated by existing market participation in compression exercises.

<sup>21</sup> See "ISDA 2009 A Yearbook of ISDA Activities," International Swaps and Derivatives Association, Inc. (2009).

<sup>22</sup> "Policy Objectives for the OTC Derivatives Markets," President's Working Group on Financial Markets (Nov. 14, 2008).

<sup>23</sup> Federal Reserve Bank of New York Staff Report No. 424: "Policy Perspectives on OTC Derivatives Market Infrastructure," Jan. 2010 (revised Mar. 2010).

<sup>19</sup> Federal Reserve Bank of New York Staff Report No. 424: "Policy Perspectives on OTC Derivatives Market Infrastructure," Jan. 2010 (revised Mar. 2010).

<sup>20</sup> See <http://www.trioptima.com>.

In March 2010, the Depository Trust and Clearing Corporation (DTCC) explicitly attributed the reduction in the gross notional value of the contracts in its warehouse to industry supported portfolio compression.<sup>24</sup> TriOptima, which offers the TriReduce portfolio compression service, estimates that it has terminated \$106.3 trillion gross notional of interest rate swaps and \$66.9 trillion gross notional of credit swaps since its inception in 2003.<sup>25</sup> Similarly, Creditex and Markit, which offer portfolio compression exercises in single name credit default swaps, have enabled participating institutions to eliminate \$4.5 trillion in notional between late 2008 through 2009.<sup>26</sup>

## 2. Proposed Compression Rule

Based upon these considerations, the Commission is proposing § 23.503, which would impose certain portfolio compression requirements upon swap dealers and major swap participants. Specifically, swap dealers and major swap participants would be required to participate in multilateral compression exercises that are offered by those DCOs or self-regulatory organizations of which the swap dealer or major swap participant is a member. The Commission would encourage swap dealers and major swap participants to work with the DCOs and self-regulatory organizations of which they are members to develop portfolio compression opportunities.

The portfolio compression obligation would be limited to swaps in which the counterparty is also a swap dealer or major swap participant and swaps that are eligible for inclusion in the exercise, as determined by those conducting the compression exercise and agreed to by those participating in the exercise. A swap dealer or major swap participant would be permitted to exclude swaps from a compression exercise if including the swap would be reasonably likely to increase significantly the risk exposure of the swap dealer or major

swap participant. A swap dealer or major swap participant also would be permitted to establish counterparty, market, cash payment, and other risk tolerances and to exclude potential counterparties from the compression exercise, provided that the swap dealer or major swap participant is not using the risk tolerances or counterparty exclusions to evade the compression requirements.

In recognition that portfolio compression currently is not available for all asset classes and all transactions within an asset class,<sup>27</sup> the Commission also is proposing that swap dealers and major swap participants be required to terminate bilaterally all fully offsetting swaps between them by the close of business on the business day following the day the parties entered into the offsetting swap transaction and to engage annually in bilateral portfolio compression exercises with counterparties that are also swap dealers or major swap participants. Swap dealers and major swap participants need not engage in bilateral portfolio compression exercises, however, to the extent that the counterparties have mutually participated in a multilateral exercise involving the swaps between them during the same year.

The Commission anticipates that portfolio compression exercises will be offered by additional vendors and will encompass additional products and asset classes as the industry progresses toward increased product standardization and centralized clearing. To afford the Commission the flexibility to react to the expected future availability and need for portfolio compression exercises, proposed § 23.503 also would require swap dealers and major swap participants to participate in all multilateral portfolio compression exercises required by Commission regulation or order.

Proposed § 23.503 would not mandate portfolio compression exercises for swaps outstanding between a swap dealer or a major swap participant and counterparties that are neither swap dealers nor major swap participants. Instead, swap dealers and major swap participants would be required to

maintain written policies and procedures for periodically terminating all fully offsetting swaps and periodically engaging in compression exercises.

The proposed rule would apply to all swaps within a swap portfolio as of the effective date of the regulation.

## 3. Comments Requested

The Commission is requesting comment on all aspects of the portfolio compression rule, and specifically requests comment on the following questions:

- Should the Commission require swap dealers and major swap participants to engage in bilateral and multilateral compression exercises, particularly with respect to transactions where the counterparty is not a swap dealer or major swap participant?
- Should the compression requirement be restricted to particular asset classes?
- With what frequency should bilateral or multilateral compression be required?
- What are the costs associated with engaging in bilateral and multilateral compression and are such costs a barrier to participation?
- Should the Commission expressly define the transactions that are eligible for inclusion in a portfolio compression exercise or leave that determination to those conducting the compression exercise and/or to those participating in the exercise?
- What factors (*e.g.*, sufficiently standardized terms) would render a particular swap eligible or ineligible for inclusion in a bilateral or multilateral compression exercise?
- Should the Commission provide specific risk management, accounting, regulatory, and other rationale under which a swap dealer or major swap participant may exclude particular swaps transactions from a multilateral portfolio compression exercise?
- How much time would be sufficient to allow swap dealers and major swap participants to come into compliance with the proposed portfolio compression requirements?
- Should the Commission require participation in compression exercises conducted only by registered derivatives clearing organizations or by all central counterparties of which the swap dealer or major swap participant may be a member?
- Should financial entities as defined in proposed § 23.500 be subject to the provisions of § 23.503(a), (b), and (c)?

<sup>24</sup> DTCC Press Release, "DTCC Trade Information Warehouse Completes Record Year Processing OTC Credit Derivatives" (Mar. 11, 2010). Notably, beginning in August 2008, ISDA encouraged compression exercises for credit default swaps by selecting the service provider and defining the terms of service.

<sup>25</sup> See <http://www.trioptima.com>. Between 2007 and 2008, TriOptima reduced \$54.7 trillion gross notional of interest rate swaps and \$49.1 trillion gross notional of credit swaps. In March of 2010, the staff of the Federal Reserve Bank of New York estimated that since 2008 nearly \$50 trillion gross notional of credit default swap positions has been eliminated through portfolio compression. Federal Reserve Bank of New York Staff Report No. 424: "Policy Perspectives on OTC Derivatives Market Infrastructure," Jan. 2010 (revised Mar. 2010).

<sup>26</sup> See <http://www.isdacdmarketplace.com>.

<sup>27</sup> At the present time, the principal portfolio compression vendors offer compression exercises for limited types of trades in a limited number of asset classes. Compression currently is available for certain interest rate swaps and credit default swaps and, to a lesser degree, specific energy products. For example, TriOptima's TriReduce service provides portfolio compression services for: (1) interest rate swap transactions in twenty-three currencies; (2) credit default swaps (index, single name, and tranches); and (3) a more limited number of energy products. Markit and Creditex offer portfolio compression for credit default swaps.

### III. Related Matters

#### A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities.<sup>28</sup> The Commission previously has established certain definitions of “small entities” to be used in evaluating the impact of its regulations on small entities in accordance with the RFA.<sup>29</sup> The proposed rules would affect swap dealers and major swap participants.

Swap dealers and major swap participants are new categories of registrants. Accordingly, the Commission has not previously addressed the question of whether such persons are, in fact, small entities for purposes of the RFA. However, the Commission previously has determined that futures commission merchants should not be considered to be small entities for purposes of the RFA.<sup>30</sup> The Commission’s determination was based, in part, upon the obligation of futures commission merchants to meet the minimum financial requirements established by the Commission to enhance the protection of customers’ segregated funds and protect the financial condition of futures commission merchants generally.<sup>31</sup> Like futures commission merchants, swap dealers will be subject to minimum capital and margin requirements and are expected to comprise the largest global financial firms. The Commission is required to exempt from swap dealer designation any entities that engage in a de minimis level of swaps dealing in connection with transactions with or on behalf of customers. The Commission anticipates that this exemption would tend to exclude small entities from registration. Accordingly, for purposes of the RFA for this rulemaking, the Commission is hereby proposing that swap dealers not be considered “small entities” for essentially the same reasons that futures commission merchants have previously been determined not to be small entities and in light of the exemption from the definition of swap dealer for those engaging in a de minimis level of swap dealing.

The Commission also has previously determined that large traders are not “small entities” for RFA purposes.<sup>32</sup> In that determination, the Commission considered that a large trading position

was indicative of the size of the business. Major swap participants, by statutory definition, maintain substantial positions in swaps or maintain outstanding swap positions that create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets. Accordingly, for purposes of the RFA for this rulemaking, the Commission is hereby proposing that major swap participants not be considered “small entities” for essentially the same reasons that large traders have previously been determined not to be small entities.

Moreover, the Commission is carrying out Congressional mandates by proposing this regulation. Specifically, the Commission is proposing these regulations to comply with the Dodd-Frank Act, the aim of which is to reduce systemic risk presented by swap dealers and swap market participants through comprehensive regulation. The Commission does not believe that there are regulatory alternatives to those being proposed that would be consistent with the statutory mandate. Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed rules will not have a significant economic impact on a substantial number of small entities.

#### B. Paperwork Reduction Act

The Paperwork Reduction Act (PRA)<sup>33</sup> imposes certain requirements on Federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. This proposed rulemaking would result in new collection of information requirements within the meaning of the PRA. The Commission therefore is submitting this proposal to the Office of Management and Budget (OMB) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for this collection of information is “Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants.” An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The OMB has not yet assigned this collection a control number.

The collection of information under these proposed rules is necessary to implement certain provisions of the CEA, as amended by the Dodd-Frank Act. Specifically, it is essential to

ensuring that swap dealers and major swap participants document the terms of all of their swaps, reconcile their swap portfolios to resolve any discrepancies or disputes, and wholly or partially terminate some or all outstanding swaps through regular compression exercises. Commission staff would use the information related to each of these important risk-reducing activities when conducting the Commission’s examination and oversight program with respect to the registrants.

If the proposed regulations are adopted, responses to this collection of information would be mandatory. The Commission will protect proprietary information according to the Freedom of Information Act and 17 CFR part 145, “Commission Records and Information.” In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public “data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers.” The Commission also is required to protect certain information contained in a government system of records according to the Privacy Act of 1974, 5 U.S.C. 552a.

#### 1. Information Provided by Reporting Entities/Persons

Proposed §§ 23.501, 23.502, and 23.503 would require swap dealers and major swap participants to make and retain records of confirmations, portfolio reconciliations, and portfolio compression exercises. The proposed regulations do not impose any reporting requirements. The proposed regulations will be an important part of the Commission’s regulatory program for swap dealers and major swap participants. The information required to be preserved would be used by representatives of the Commission and any examining authority responsible for reviewing the activities of the swap dealer or major swap participant to ensure compliance with the CEA and applicable Commission regulations.

The annual burden associated with these proposed regulations is estimated to be 1,282.5 hours, at an annual cost of \$1,282,250 for each swap dealer and major swap participant. Burden means the total time, effort or financial resources expended by persons to generate, maintain, retain, disclose, or provide information to or for a Federal agency. Specifically, the Commission anticipates that swap dealers and major swap participants will spend an average of 40 hours per year drafting and

<sup>28</sup> 5 U.S.C. 601 *et seq.*

<sup>29</sup> 47 FR 18618, Apr. 30, 1982.

<sup>30</sup> *Id.* at 18619.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at 18620.

<sup>33</sup> 44 U.S.C. 3501 *et seq.*

updating the policies and procedures required by the proposed regulations; 252 hours per year making and retaining the acknowledgment and confirmation records required by proposed § 23.501; 812 hours per year making and retaining the portfolio reconciliation records required by proposed § 23.502; and 178.5 hours per year making and retaining the bilateral offset and portfolio compression records required by proposed § 23.503.

It is not currently known how many swap dealers and major swap participants will become subject to these rules, and this will not be known to the Commission until the registration requirements for these entities become effective after July 16, 2011, the date on which the Dodd-Frank Act becomes effective. While the Commission believes there will be approximately 200 swap dealers and 50 major swap participants, it has taken a conservative approach, for PRA purposes, in estimating that there will be a combined number of 300 swap dealers and major swap participants who will be required to comply with the recordkeeping requirements of the proposed rules. The Commission estimated the number of affected entities based on industry data.

According to recent Bureau of Labor Statistics findings, the mean hourly wage of an employee under occupation code 11-3031, "Financial Managers," (which includes operations managers) that is employed by the "Securities and Commodity Contracts Intermediation and Brokerage" industry is \$74.41.<sup>34</sup> Because swap dealers and major swap participants include large financial institutions whose operations management employees' salaries may exceed the mean wage, the Commission has estimated the cost burden of these proposed regulations based upon an average salary of \$100 per hour.

Accordingly, the estimated burden was calculated as follows:

*Drafting and Updating Policies and Procedures.* This hourly burden arises from the time necessary to develop and periodically update the policies and procedures required by the proposed regulations.

*Number of registrants:* 300.

*Frequency of collection:* Initial implementation, updating as needed.

*Estimated number of annual responses per registrant:* 1.

*Estimated aggregate number of annual responses:* 300.

*Estimated annual hour burden per registrant:* 40 hours.

*Estimated aggregate annual hour burden:* 12,000 burden hours [300 registrants × 40 hours per registrant].

*Acknowledgment and Confirmation Recordkeeping.* This hourly burden arises from the proposed requirement that swap dealers and major swap participants make and maintain records of the date and time of transmission to, or receipt from, a counterparty of an acknowledgment or confirmation; the length of time between the acknowledgment and confirmation of each swap; and the length of time between execution and confirmation of each swap.

*Number of registrants:* 300.

*Frequency of collection:* daily.

*Estimated number of annual responses per registrant:* 252 [252 trading days].

*Estimated aggregate number of annual responses:* 75,600 [300 registrants × 252 trading days].

*Estimated annual hour burden per registrant:* 252 [252 trading days × 1 hour per day].

*Estimated aggregate annual hour burden:* 75,600 burden hours [300 × 252 hours].

*Portfolio Reconciliation Recordkeeping.* This hourly burden arises from the proposed requirement that swap dealers and major swap participants make and maintain records of the portfolio reconciliation exercises in which they engage. Registrants would be required to reconcile portfolios with counterparties that are swap dealers and major swap participants on a daily, weekly, or quarterly basis, depending upon the size of the portfolio. They also would be required to maintain policies and procedures for conducting portfolio reconciliation with other counterparties with similar frequency.

*Number of registrants:* 300.

*Frequency of collection:* daily, weekly, or quarterly.

*Estimated number of annual responses per registrant:* 8,120.<sup>35</sup>

<sup>35</sup> Due to the absence of prior experience in regulating swap dealers and major swap participants and with regulations similar to the proposed rules, the actual, average number of counterparties that a swap dealer or major swap participant is likely to have and the average size of its portfolio with particular counterparties is uncertain. The estimate of 5,600 portfolio reconciliation records is based upon the assumption that each swap dealer and major swap participant engages in swap transactions with approximately one third (100) of the other swap dealers or major swap participants and that 10% of such portfolios would require daily reconciliation; 20% would require weekly reconciliation; and 70% would require quarterly reconciliation. The estimate also is based upon the assumption that a swap dealer or major swap participant has an average of 440 other counterparties and that all of the portfolios with those counterparties generally would be limited to quarterly reconciliation. Consistent with other

*Estimated aggregate number of annual responses:* 2,436,000 [300 registrants × 8,120 responses].

*Estimated annual hour burden per registrant:* 812 hours [8,120 × .10 hours per response].

*Estimated aggregate annual hour burden:* 243,600 burden hours [300 registrants × 812 hours per registrant].

*Portfolio Compression Recordkeeping.* This hourly burden results from the proposed requirement that swap dealers and major swap participants make and maintain records of the bilateral offsets and portfolio compression exercises in which they participate, including the beginning and completion dates; the swaps that were included and excluded; the applicable risk tolerance levels; and the results of the particular exercise. The proposed regulations would require that each swap dealer and major swap participant terminate fully offsetting swaps; participate in certain multilateral compression exercises; and participate in annual bilateral portfolio compression exercises with each counterparty that is also a swap dealer or major swap participant (except to the extent that the counterparties participate in multilateral compression exercises for the same swaps). Swap dealers and major swap participants also would be required to maintain policies and procedures for periodically engaging in portfolio compression exercises with other counterparties.

*Number of registrants:* 300.

*Frequency of collection:* As needed.

*Estimated number of annual responses per registrant:* 1,029 [24 multilateral compression records<sup>36</sup> + [465 bilateral compression exercise

proposed rulemakings, the Commission has estimated that each of the 14 major swap dealers has an average 7,500 counterparties and the other 286 swap dealers and major swap participants have an average of 200 counterparties per year, for an average of 540 total counterparties per registrant. The Commission estimates that 440 of those counterparties would not be other swap dealers or major swap participants.

<sup>36</sup> This estimate assumes that swap dealers and major swap participants would engage in multilateral compression exercises for 2 asset classes at an average rate of 12 multilateral compression exercises per year (approximately 1 per month).

<sup>34</sup> <http://www.bls.gov/oes/current/oes113031.htm>.

records<sup>37</sup>] + [540 bilateral offset records<sup>38</sup>].

*Estimated aggregate number of annual responses:* 308,700 [300 registrants × 1,029 responses per year].

*Estimated annual hour burden per registrant:* 178.5 hours [24 multilateral compression records × .5 hours per records] + [465 bilateral compression exercise records × .3 hours per records] + [540 bilateral offset records × .05 hours per record].

*Estimated aggregate annual hour burden:* 53,550 burden hours [300 registrants × 178.5 hours per registrant].

Based upon the above, the aggregate hourly burden for all registrants is 334,350 hours and \$33,435,000 [334,350 × \$100 per hour].

In addition to the per hour burden discussed above, the Commission anticipates that swap dealers and major swap participants may incur minimal start-up costs in connection with the proposed recordkeeping obligations. Such costs would include the expenditures related to developing and installing new recordkeeping technology or re-programming or updating existing recordkeeping technology and systems to enable the swap dealer or major swap participant to collect, maintain, and re-produce any newly required records. The Commission believes that swap dealers and major swap participants generally could adapt their current infrastructure to accommodate the new or amended technology and thus, no significant infrastructure expenditures would be needed. The Commission estimates the programming burden hours associated with technology improvements to be 40 hours.

According to recent Bureau of Labor Statistics findings, the mean hourly wages of computer programmers under

occupation code 15–1021 and computer software engineers under program codes 15–1031 and 1032 are between \$34.10 and \$44.94.<sup>39</sup> Because swap dealers and major swap participants generally will be large entities that may engage employees with wages above the mean, the Commission has conservatively chosen to use a mean hourly programming wage of \$60 per hour. Accordingly, the start-up burden associated with the required technological improvements would be \$2,400 [\$60 × 40 hour per affected registrant] or \$720,000 in the aggregate.

## 2. Information Collection Comments

The Commission invites the public and other Federal agencies to comment on any aspect of the recordkeeping burdens discussed above. The Commission specifically requests comment on the variables used in the above-referenced hourly burden calculations. For example, the Commission requests comment on the following:

- What is the total number of swap dealers and major swap participants in the marketplace?
- What is the average number of counterparties that a swap dealer or major swap participant is likely to have?
- What percentage of those counterparties are other swap dealers or major swap participants?
- What is the average size (number of swaps) of a portfolio that a swap dealer or major swap participant is likely to have with a particular type of counterparty?
- What is the average number of acknowledgment and confirmation records that a swap dealer or major swap participant would likely be required to make under the proposed regulations?

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Comments may be submitted directly to the Office of Information and Regulatory Affairs, by fax at (202) 395–6566 or by e-mail at [OIRAsubmissions@omb.eop.gov](mailto:OIRAsubmissions@omb.eop.gov). Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Refer to the Addresses section of this notice of proposed rulemaking for comment submission instructions to the Commission.

A copy of the supporting statements for the collections of information discussed above may be obtained by visiting [RegInfo.gov](http://RegInfo.gov). OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment is best assured of having its full effect if OMB receives it within 30 days of publication.

## C. Cost-Benefit Analysis

Section 15(a) of the CEA<sup>40</sup> requires the Commission to consider the costs and benefits of its actions before issuing a rulemaking under the CEA. By its terms, Section 15(a) does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the rule outweigh its costs; rather, it requires that the Commission “consider” the costs and benefits of its actions.

Section 15(a) further specifies that costs and benefits of a proposed rulemaking shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may, in its discretion, give greater weight to any one of the five enumerated considerations and could, in its discretion, determine that, notwithstanding its costs, a particular regulation was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the CEA.

*Summary of proposed requirements.* The proposed regulations would implement new section 4s(i) of the CEA which was added by section 731 of the Dodd-Frank Act. The proposed regulations would set forth certain requirements for swap confirmations, portfolio reconciliation, and portfolio compression applicable to swap dealers

<sup>37</sup> As with other approximations set forth in this proposal, the estimate of 465 bilateral compression exercise records is based upon the assumption that each swap dealer and major swap participant engages in swap transactions with approximately one third (100) of the other swap dealers or major swap participants. Because it is anticipated that most swaps between swap dealers and major swap participants would be eligible for multilateral portfolio compression exercises, the Commission expects that a swap dealer or major swap participant would need to engage in annual bilateral compression with only one quarter of (25) such counterparties. The estimate also is based upon the assumption that the average swap dealer or major swap participant has an average of 440 non-swap dealer or major swap participant counterparties and would engage in 1 bilateral portfolio compression exercise with each. This would result in a total of 465 bilateral portfolio compression records (25 + 440).

<sup>38</sup> This estimate is based upon the assumption that each swap dealer and major swap participant will have an average of 1 set of swaps that is eligible for annual bilateral offset with each of its estimated 540 counterparties per year.

<sup>39</sup> <http://www.bls.gov/oes/current/oes113031.htm>.

<sup>40</sup> 7 U.S.C. 19(a).

and major swap participants and related recordkeeping requirements.

**Costs.** With respect to costs, the Commission has determined that the nominal cost that would be borne by swap dealers and major swap participants to institute the policies and procedures and recordkeeping systems necessary to satisfy the new regulatory requirements are far outweighed by the benefits that would accrue to the financial system as a whole as a result of the implementation of the rules. It is expected that any additional cost imposed by the confirmation, portfolio reconciliation, and portfolio compression requirements of proposed §§ 23.501, 23.502, and 23.503 would be minimal because the confirmation, reconciliation, and compression processes required under the rules are already part of a prudent operational processing regime that many, if not most, swap dealers and major swap participants already undertake as part of their ordinary course of business.

Moreover, most swap dealers and major swap participants have adequate resources and existing back office operational systems that are capable of adjusting to the new regulatory framework without material diversion of resources away from commercial operations. As discussed in the preamble, there are also numerous third-party vendors that provide confirmation, compression, and reconciliation services. Some of these providers charge fees based on results achieved (such as number of swaps compressed) and, thus, the cost would be necessarily proportionate to the benefit.

**Benefits.** With respect to benefits, the Commission has determined that the proposed regulations would require a swap dealer or major swap participant to confirm, reconcile, and compress their swaps in a manner that will result in reduced risk, increased transparency, and greater market integrity in the swaps market. The proposed swap confirmation, portfolio reconciliation, and portfolio compression rules would further the goal of avoiding market disruptions and financial losses to market participants and the general public. Among other benefits, the proposed rules would promote levels of operational scalability and resilience that are most evident in periods of sustained high volume and market volatility. Therefore, the Commission believes it is prudent to prescribe these proposed regulations.

**Public Comment.** The Commission invites public comment on its cost-benefit considerations. Commentators are also invited to submit any data or

other information that they may have quantifying or qualifying the costs and benefits of the proposed rules with their comment letters.

#### List of Subjects in 17 CFR Part 23

Antitrust, Commodity futures, Conduct standards, Conflict of Interests, Major swap participants, Reporting and recordkeeping, Swap dealers, Swaps.

For the reasons stated in this release, the Commission proposes to amend 17 CFR part 23, as proposed to be added in FR Doc. 2010-XXXX, published on XXXX (75 FR XXXX), as follows:

#### PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

1. The authority citation for part 23 to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b-1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

2. Subpart I, (consisting of §§ 23.500, 23.501, 23.502, and 23.503) is added to read as follows:

##### Subpart I—Swap Documentation

Sec.

- 23.500 Definitions.
- 23.501 Swap confirmation.
- 23.502 Portfolio reconciliation.
- 23.503 Portfolio compression.

##### Subpart I—Swap Documentation

###### § 23.500 Definitions.

For purposes of subpart I, the following terms shall be defined as provided.

(a) *Acknowledgment* means a written or electronic record of all of the terms of a swap signed and sent by one counterparty to the other.

(b) *Bilateral portfolio compression exercise* means an exercise in which two swap counterparties wholly or partially terminate some or all of the swaps outstanding between those counterparties and replace those swaps with a smaller number of swaps whose combined notional value is less than the combined notional value of the original swaps included in the exercise.

(c) *Confirmation* means the consummation (electronically or otherwise) of legally binding documentation (electronic or otherwise) that memorializes the agreement of the counterparties to all of the terms of a swap transaction. A confirmation must be in writing (whether electronic or otherwise) and must legally supersede any previous agreement (electronically or otherwise). A confirmation is created when an acknowledgment is manually, electronically, or by some other legally equivalent means, signed by the receiving counterparty.

(d) *Execution* means, with respect to a swap transaction, an agreement by the counterparties (whether orally, in writing, electronically, or otherwise) to the terms of the swap transaction that legally binds the counterparties to such terms under applicable law.

(e) *Financial entity* has the meaning given to the term in section 2h(7)(C) of the Act and any Commission regulations promulgated thereunder, provided that the term shall not include a swap dealer or major swap participant.

(f) *Fully offsetting swaps* means swaps of equivalent terms where no net cash flow would be owed to either counterparty after the offset of payment obligations thereunder.

(g) *Material terms* means all terms of a swap required to be reported in accordance with part 45 of this chapter.

(h) *Multilateral portfolio compression exercise* means an exercise in which multiple swap counterparties wholly or partially terminate some or all of the swaps outstanding among those counterparties and replace the swaps with a smaller number of swaps whose combined notional value is less than the combined notional value of the original swaps included in the exercise. The replacement swaps may be with the same or different counterparties.

(i) *Portfolio reconciliation* means 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.

(j) *Processed electronically* means to be entered into a swap dealer or major swap participant's computerized processing systems to facilitate clearance and settlement.

(k) *Prudential regulator* has the meaning given to the term in section 1a(39) of the Commodity Exchange Act and includes the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Association, and the Federal Housing Finance Agency, as applicable to the swap dealer or major swap participant. The term also includes the Federal Deposit Insurance Corporation, with respect to any financial company as defined in section 201 of the Dodd-Frank Wall Street Reform and Consumer Protection Act or any insured depository institution

under the Federal Deposit Insurance Act, and with respect to each affiliate of any such company or institution.

(l) *Swap portfolio* means all swaps currently in effect between a particular swap dealer or major swap participant and a particular counterparty.

(m) *Swap transaction* means 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.

(n) *Unwind proposal* means a proposal offered by the sponsor of a multilateral portfolio compression exercise which, if accepted, would wholly or partially terminate some or all of the original swaps included in the exercise.

(o) *Valuation* means the current market value or net present value of a swap.

#### § 23.501 Swap confirmation.

(a) *Confirmation*.

(1) Each swap dealer and major swap participant entering into a swap transaction with a counterparty that is a swap dealer or major swap participant shall execute a confirmation for the swap transaction according to the following schedule:

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

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

(iii) For any swap transaction that cannot be processed electronically by the swap dealer or major swap participant, within the same calendar day as execution.

(2) Each swap dealer and major swap participant entering into a swap transaction with a counterparty that is not a swap dealer or a major swap participant shall send an acknowledgment of such swap transaction according to the following schedule:

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

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

(iii) For any swap transaction that cannot be processed electronically by the swap dealer or major swap participant, within the same calendar day as execution.

(3) Each swap dealer and major swap participant shall establish, maintain, and enforce written policies and procedures reasonably designed to ensure that it executes a confirmation for each swap transaction that it enters into with a counterparty that is a financial entity within the same calendar day as execution and with a counterparty that is not a swap dealer, major swap participant, or a financial entity not later than the next business day after execution. Such procedures shall include a requirement that, prior to execution of any such swap, the swap dealer or major swap participant furnish to a prospective counterparty, or receive from a prospective counterparty, a draft acknowledgment specifying all terms of the swap transaction other than the applicable pricing and other relevant terms that are to be expressly agreed at execution.

(b) *Recordkeeping*. (1) Each swap dealer and major swap participant shall make and retain a record of:

(i) The date and time of transmission to, or receipt from, a counterparty of any acknowledgment;

(ii) The date and time of transmission to, or receipt from, a counterparty of any confirmation;

(iii) The length of time between acknowledgment and confirmation of each swap; and

(iv) The length of time between execution and confirmation of each swap.

(2) All records required to be maintained pursuant to this section shall be maintained in accordance with § 1.31 and shall be made available promptly upon request to any representative of the Commission or any applicable prudential regulator, or with regard to swaps defined in section 1a(47)(A)(v), to any representative of the Commission, the Securities and Exchange Commission, or any applicable prudential regulator.

#### § 23.502 Portfolio reconciliation.

(a) *Swaps with swap dealers or major swap participants*. Each swap dealer and major swap participant shall engage in portfolio reconciliation as follows for all swaps in which its counterparty is also a swap dealer or major swap participant.

(1) Each swap dealer or major swap participant shall agree in writing with each of its counterparties on the terms of the portfolio reconciliation.

(2) The portfolio reconciliation may be performed on a bilateral basis by the counterparties or by a qualified third party.

(3) The portfolio reconciliation shall be performed no less frequently than:

(i) Once each business day for each swap portfolio that includes 300 or more swaps;

(ii) Once each week for each swap portfolio that includes more than 50 but fewer than 300 swaps on any business day during any week; and

(iii) Once each calendar quarter for each swap portfolio that includes no more than 50 swaps at any time during the calendar quarter.

(4) Each swap dealer and major swap participant shall resolve immediately any discrepancy in a material term of a swap identified as part of a portfolio reconciliation.

(5) Each swap dealer and major swap participant shall resolve any discrepancy in a valuation identified as part of a portfolio reconciliation within one business day. A difference between the lower valuation and the higher valuation of less than 10% of the higher valuation need not be deemed a discrepancy.

(b) *Swaps with entities other than swap dealers or major swap participants*. Each swap dealer and major swap participant shall establish, maintain, and enforce written policies and procedures for engaging in portfolio reconciliation as follows for all swaps in which its counterparty is neither a swap dealer nor a major swap participant.

(1) Each swap dealer or major swap participant shall agree in writing with each of its counterparties on the terms of the portfolio reconciliation.

(2) The portfolio reconciliation may be performed on a bilateral basis by the counterparties or by a qualified third party.

(3) The portfolio reconciliation shall be performed no less frequently than:

(i) Once each business day for each swap portfolio that includes 500 or more swaps;

(ii) Once each week for each swap portfolio that includes more than 100 but fewer than 500 swaps on any business day during any week; and

(iii) Once each calendar quarter for each swap portfolio that includes no more than 100 swaps at any time during the calendar quarter.

(4) Each swap dealer or major swap participant shall establish, maintain, and enforce written procedures reasonably designed to resolve any discrepancies in the material terms or valuation of each swap identified as part of a portfolio reconciliation process in a timely fashion. A difference between the lower valuation and the higher valuation of less than 10% of the higher valuation need not be deemed a discrepancy.

(c) *Reconciliation of cleared swaps*. Nothing in this section shall apply to a

swap that is cleared by a derivatives clearing organization.

(d) *Recordkeeping.* A record of each swap portfolio reconciliation, including a record of each discrepancy and the length of time for resolution of each discrepancy not resolved within one business day, shall be maintained in accordance with § 1.31 and shall be made available promptly upon request to any representative of the Commission or any applicable prudential regulator, or with regard to swaps defined in section 1a(47)(A)(v) of the Act, to any representative of the Commission, the Securities and Exchange Commission, or any applicable prudential regulator.

#### **§ 23.503 Portfolio compression.**

(a) *Bilateral offset.* Each fully offsetting swap between a swap dealer or major swap participant and another swap dealer or major swap participant shall be terminated no later than the close of business on the business day following the day on which the counterparties entered into the fully offsetting swap.

(b) *Bilateral compression.* Each swap dealer and major swap participant shall engage in a bilateral portfolio compression exercise for each swap in which the counterparty is also a swap dealer or major swap participant at least once per calendar year, except to the extent that the swap dealer or major swap participant and the counterparty have participated in a multilateral compression exercise involving such swap during the same calendar year.

(c) *Multilateral compression.* Each swap dealer and major swap participant shall engage in the following portfolio compression exercises for each swap in which its counterparty is also a swap dealer or major swap participant:

(1) Each swap dealer and major swap participant shall participate in all multilateral portfolio compression exercises required by Commission regulation or order.

(2) Each swap dealer and major swap participant shall participate in all multilateral portfolio compression exercises that are initiated, offered, or sponsored by any of the following entities to the extent that any swap in the portfolio of the swap dealer or major swap participant is eligible for inclusion in the exercise:

(i) Any derivatives clearing organization of which the swap dealer or major swap participant is a member; or

(ii) Any self-regulatory organization of which the swap dealer or major swap participant is a member.

(3) Each swap dealer and major swap participant shall comply with the

following with respect to each multilateral portfolio compression exercise in which it participates:

(i) *Transactions included.* Each swap dealer and major swap participant shall include in the multilateral portfolio compression exercise all swaps in which its counterparty is also a swap dealer or major swap participant that are eligible to be included in the particular exercise, unless including the swap would be reasonably likely to significantly increase the risk exposure of the swap dealer or major swap participant.

(ii) *Counterparty, market, and cash payment risk tolerances.*

Notwithstanding § 23.503(c)(3)(i), a swap dealer or a major swap participant may establish counterparty, market, cash payment, or other risk tolerances or exclude specific potential counterparties, provided that the swap dealer or major swap participant does not use such risk tolerances or counterparty exclusions to evade the requirements of this regulation.

(iii) *Acceptance of unwind proposal.*

No swap dealer or major swap participant shall unreasonably withhold, delay, or condition consent to an unwind proposal.

(d) *Policies and procedures.*

(1) Each swap dealer and major swap participant shall establish, maintain, and enforce written policies and procedures for engaging in the bilateral and multilateral portfolio compression exercises required by this section with respect to all swaps in which its counterparty is also a swap dealer or major swap participant.

(2) Each swap dealer and major swap participant shall establish, maintain, and enforce written policies and procedures for periodically terminating fully offsetting swaps and for periodically engaging in portfolio compression exercises with respect to swaps in which its counterparty is an entity other than a swap dealer or major swap participant, to the extent that the outstanding swaps are able to be terminated through a portfolio compression exercise.

(e) *Recordkeeping.* (1) Each swap dealer and major swap participant shall make and maintain a record of each bilateral offset and each bilateral or multilateral portfolio compression exercise in which it participates, including the beginning and completion dates of the offset or exercise; the included swaps and counterparties thereto; the swaps that were eligible for inclusion in the exercise, but were excluded by the swap dealer or major swap participant and the reason for the exclusion; the counterparty, market,

cash payment, or other risk tolerance levels set by the swap dealer or major swap participant; and the results of the compression, including the identification of the swaps that were terminated and any new swaps and the counterparties thereto that resulted from the exercise.

(2) All records required to be maintained pursuant to this section shall be maintained in accordance with § 1.31 and shall be made available promptly upon request to any representative of the Commission or any applicable prudential regulator, or with regard to swaps defined in section 1a(47)(A)(v) of the Act, to any representative of the Commission, the Securities and Exchange Commission, or any applicable prudential regulator.

Issued in Washington, DC on December 16, 2010, by the Commission.

**David A. Stawick,**

*Secretary of the Commission.*

#### **Appendices to Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants—Commissioners Voting Summary and Statements of Commissioners**

**Note:** The following appendices will not appear in the Code of Federal Regulations.

##### **Appendix 1—Commissioners Voting Summary**

On this matter, Chairman Gensler and Commissioners Dunn, Sommers, Chilton and O'Malia voted in the affirmative. No Commissioner voted in the negative.

##### **Appendix 2—Statement of Chairman Gary Gensler**

I support the proposed rulemaking that establishes essential business conduct standards for swap dealers and major swap participants. Today's rule establishes confirmation, portfolio reconciliation and portfolio compression requirements for such parties. The proposed regulations are consistent with Congress's direction through the Dodd-Frank Act to prescribe standards for the timely and accurate confirmation, processing, netting and valuation of swap transactions. One of the primary goals of Dodd-Frank Act was to establish a comprehensive regulatory framework that would reduce risk, increase transparency and promote market integrity. The proposed regulations accomplish this goal by establishing procedures that will promote legal certainty regarding swap transactions, early resolutions of valuation disputes, enhanced understanding of one counterparty's risk exposure to another, reduced operational risk and increased operational efficiency.

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