

# Rules and Regulations

Federal Register

Vol. 86, No. 27

Thursday, February 11, 2021

This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect, most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.

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## COMMODITY FUTURES TRADING COMMISSION

### 17 CFR Part 36

RIN 3038-AE25

### Exemptions From Swap Trade Execution Requirement

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Final rule.

**SUMMARY:** The Commodity Futures Trading Commission (“Commission” or “CFTC”) is adopting a final rule (“Final Rule”) that establishes two exemptions from the statutory requirement to execute certain types of swaps on a swap execution facility (“SEF”) or a designated contract market (“DCM”) (this requirement, the “trade execution requirement”).

**DATES:** The Final Rule is effective on March 15, 2021.

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### I. Background and Introduction

#### A. Statutory and Regulatory History

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>1</sup> amended the Commodity Exchange Act (“CEA” or “Act”)<sup>2</sup> to establish a comprehensive new swaps regulatory framework that addresses, *inter alia*, the trading of swaps and the registration and oversight of SEFs.<sup>3</sup> CEA section 2(h)(8) provides that swap transactions that are subject to the swap clearing requirement under CEA section 2(h)(1)(A)<sup>4</sup> must be executed on a DCM, a registered SEF, or a SEF that is exempt from registration pursuant to CEA

<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, tit. VII, 124 Stat. 1376 (2010) (codified as amended in various sections of 7 U.S.C.), <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2013-12242a.pdf> (“Dodd-Frank Act”).

<sup>2</sup> 7 U.S.C. 1 *et seq.*

<sup>3</sup> 7 U.S.C. 2(h)(8), 7b–3. As amended, CEA section 1a(50) defines a SEF as a trading system or platform that allows multiple participants to execute or trade swaps with multiple participants through any means of interstate commerce.” 7 U.S.C. 1a(50). CEA section 5h(a)(1) requires an entity to register as a SEF or a DCM prior to operating a facility for the trading or processing of swaps. 7 U.S.C. 7b–3(a)(1). CEA section 5h(f) requires registered SEFs to comply with fifteen core principles. 7 U.S.C. 7b–3(f).

<sup>4</sup> Section 723(a)(3) of the Dodd-Frank Act added a new CEA section 2(h) to establish the clearing requirement for swaps. 7 U.S.C. 2(h). CEA section 2(h)(1)(A) provides that it is unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization that is registered under the Act or a derivatives clearing organization that is exempt from registration under the Act if the swap is required to be cleared. 7 U.S.C. 2(h)(1)(A). CEA section 2(h)(2) specifies the process for the Commission to review and determine whether a swap, or a group, category, type or class of swap should be subject to the clearing requirement. 7 U.S.C. 2(h)(2). The Commission further implemented the clearing requirement determination process under regulation 39.5 and part 50. Part 50 specifies the interest rate and credit default swaps that are currently subject to the Commission’s clearing requirement. 17 CFR part 50.

section 5h(g) (“Exempt SEF”),<sup>5</sup> unless (i) no DCM or SEF<sup>6</sup> “makes the swap available to trade” or (ii) the related transaction is subject to the exception from the swap clearing requirement under CEA section 2(h)(7). The swap clearing requirement exception under CEA section 2(h)(7) applies to non-financial entities that are using swaps to hedge or mitigate commercial risk and notify the Commission how they generally meet their financial obligations related to uncleared swaps, and has been implemented under Commission regulation 50.50.<sup>7</sup>

In 2013, pursuant to its discretionary rulemaking authority in CEA sections 5h(f)(1) and 8a(5), the Commission issued an initial set of rules implementing this statutory framework for swap trading and the registration and oversight of SEFs (“2013 SEF Rules”).<sup>8</sup>

In November 2018, the Commission issued a proposed rule (“Proposed

<sup>5</sup> The Commission notes that CEA section 2(h)(8)(A)(ii) contains a typographical error that specifies CEA section 5h(f), rather than CEA section 5h(g), as the provision that allows the Commission to exempt a SEF from registration. Where appropriate, the Commission corrects this reference in the discussion herein.

<sup>6</sup> CEA sections 2(h)(8)(A)(i)–(ii) provide that with respect to transactions involving swaps subject to the clearing requirement, counterparties shall execute the transaction on a board of trade designated as a contract market under section 5; or execute the transaction on a swap execution facility registered under 5h or a swap execution facility that is exempt from registration under section 5h(g) of the Act. Given this reference in CEA section 2(h)(8)(A)(ii), the Commission accordingly interprets “swap execution facility” in CEA section 2(h)(8)(B) to include a swap execution facility that is exempt from registration pursuant to CEA section 5h(g).

<sup>7</sup> This regulation codifies the statutory exception to the swap clearing requirement set forth in 7 U.S.C. 2(h)(7)(A). *See infra* notes 19–20 and accompanying text. Recently, the Commission renumbered Commission regulation 50.50(d) as a new numbered section and heading, namely, Commission regulation 50.53. A stand-alone exemption from the clearing requirement for certain banks, savings associations, farm credit system institutions, and credit unions separated this exemption from the non-financial entities’ exemption provided for under CEA section 2(h)(7) and codified in regulation 50.50(a)–(c). *See* Swap Clearing Requirement Exemptions, 85 FR 76428 (Nov. 30, 2020).

<sup>8</sup> Core Principles and Other Requirements for Swap Execution Facilities, 78 FR 33476 (Jun. 4, 2013) (“SEF Core Principles Final Rule”); Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act, 78 FR 33606 (Jun. 4, 2013) (“MAT Final Rule”).

Rule”), again under CEA sections 5h(f)(1) and 8a(5), that set forth comprehensive structural reforms to the SEF regulatory regime.<sup>9</sup> For example, the Proposed Rule would have removed existing limitations on swap execution methods on SEFs,<sup>10</sup> while expanding the categories of swaps that are subject to the trade execution requirement as well as the types of entities that must register as SEFs. In addition to these broad reforms, the Proposed Rule also contained, among other things, more targeted regulatory proposals to codify exemptions from the trade execution requirement, including two such exemptions linked to exceptions to, or exemptions from, the swap clearing requirement.<sup>11</sup>

Commenters provided limited and generally positive feedback regarding these two proposed exemptions from the trade execution requirement.<sup>12</sup> By contrast, the Proposed Rule’s broader market reforms elicited a number of public comments expressing concerns with the expansive scope of the changes and recommending that the Commission focus on more targeted improvements to the swap trading regulatory regime.<sup>13</sup> In

<sup>9</sup> Swap Execution Facilities and Trade Execution Requirement, 83 FR 61946 (Nov. 30, 2018).

<sup>10</sup> Under the CFTC’s current regulations, swaps subject to the trade execution requirement must be executed via a central limit order book (“Order Book”) or a request for quote to no fewer than three unaffiliated market participants in conjunction with an Order Book (“RFQ”). 17 CFR 37.9(a).

<sup>11</sup> 83 FR at 62036–62040. The Proposed Rule also included a trade execution exemption for swap components of package transactions that includes both a swap that is otherwise subject to the trade execution requirement and a new bond issuance (“New Issuance Bonds package transactions”). The Commission in a separate proposal, that sought to codify the majority of relief currently provided to package transactions, also proposed an exemption from the trade execution requirement for swap components of New Issuance Bond package transactions. See Swap Execution Facility Requirements and Real-Time Reporting Requirements, 85 FR 9407 (Feb. 19, 2020). On November 18, 2020, the Commission adopted that exemption in a separate rulemaking, as § 36.1(a) of its regulations. See Swap Execution Facility Requirements, 85 FR 82313 (Dec. 18, 2020).

<sup>12</sup> See Comment Letter from Japanese Bankers Association at 4 (Mar. 13, 2019) (“JBA Letter”); Comment Letter from Citadel and Citadel Securities at 40–41 (Mar. 15, 2019) (“Citadel Letter”). As discussed below, Citadel recommended certain limitations on the applicability of these exemptions. While the Commission received numerous comments on the Proposed Rule, only the JBA Letter and Citadel Letter commented directly on the two proposed exemptions addressed in these Final Rules.

<sup>13</sup> See, e.g., Comment Letter from the Alternative Investment Management Association at 1–2 (Feb. 25, 2019) (urging the CFTC “to approach any change to swap execution facilities and trade execution in a phased and targeted manner, rather than adopt a wholesale package of changes in a single rulemaking”); Comment Letter from Managed Funds Association at 2–3 (Mar. 15, 2019) (expressing concern with the breadth of the

light of available resources and current priorities, the Commission agrees that it is appropriate to proceed with incremental improvements rather than a wholesale reform package at this time.<sup>14</sup> Accordingly, this Final Rule addresses only the two proposed exemptions from the trade execution requirement linked to the swap clearing requirement’s exemptions and exceptions under part 50, such as the end-user exception under Commission regulation 50.50, the exemption for co-operatives under Commission regulation 50.51, and the inter-affiliate exemption under Commission regulation 50.52.<sup>15</sup> Additional targeted improvements to the swap trading regulatory framework have been and will continue to be made via discrete rulemakings.<sup>16</sup>

### B. Summary of the Final Rule

The Final Rule establishes two exemptions from the trade execution requirement for swaps, both of which are linked to the Commission’s exemptions from, and exceptions to, the swap clearing requirement. The first such trade execution requirement exemption applies to a swap that qualifies for, and meets the associated requirements of, any exception or exemption under part 50 of the Commission’s regulations. The second codifies relief provided under CFTC Letter No. 17–67, and prior staff

Proposed Rule and recommending targeted rather than comprehensive changes to the swap trading framework); Comment Letter from IATP at 3–4 (Mar. 15, 2019) (same); Comment Letter from Securities Industry and Financial Markets Association at 1 (Mar. 15, 2019) (“SIFMA Letter”) (same); Comment Letter from SIFMA Asset Management Group at 1 (Mar. 15, 2019) (same); Comment Letter from Tradeweb Markets LLC at 1–2 (Mar. 14, 2019) (“Tradeweb Letter”) (same); Comment Letter from Wellington Management Company LLP at 1 (Mar. 15, 2019) (same); see also Comment Letter from Futures Industry Association at 7–9 (Mar. 15, 2019) (“FIA Letter”) (stating that proposed market reforms “would present tall operational challenges and impose substantial costs on all market participants”); Comment Letter from Commodity Markets Council at 2 (Mar. 15, 2019) (same).

<sup>14</sup> In addition, the Proposed Rule addressed a number of SEF operational challenges arising from incongruities between the 2013 SEF Rules and existing technology and market practice. Proposed solutions to these operational challenges also received broad support from commenters. The Commission finalized certain of these proposals in a parallel rulemaking.

<sup>15</sup> See *infra* note 23.

<sup>16</sup> For example, the Commission recently codified staff no-action relief related to block trades, error trades, and package transactions. See Real-Time Public Reporting Requirements, 85 FR 75422 (Nov. 25, 2020) (codifying staff no-action relief related to block trades). The adopting release codifying staff no-action relief related to package transactions and error trades is available on the Commission’s website at <https://www.cftc.gov/media/5276/votingdraft111820b/download>.

letters,<sup>17</sup> and applies to a swap that is entered into by eligible affiliate counterparties and cleared, regardless of the affiliates’ ability to claim the inter-affiliate clearing exemption under § 50.52 of the Commission’s regulations.

## II. Part 36—Trade Execution Exemptions Linked to Swap Clearing Requirement Exceptions and Exemptions

### A. Background and Proposed Rule

CEA section 2(h)(8) specifies that swap transactions that are excepted from the clearing requirement pursuant to CEA section 2(h)(7) are not subject to the trade execution requirement.<sup>18</sup> CEA section 2(h)(7)(C)(i), which is codified in Commission regulation 50.50, is known as the “end-user exception” and provides an exception from the swap clearing requirement if one of the counterparties to the transaction (i) is not a financial entity; (ii) is using the swap to hedge or mitigate commercial risk; and (iii) notifies the Commission as to how it generally meets its financial obligations associated with entering into uncleared swaps.<sup>19</sup> The Commission adopted requirements under § 50.50 to implement this exception.<sup>20</sup> CEA section 2(h)(7)(C)(ii) provided the Commission with the authority to consider whether to exempt from the definition of “financial entity” small banks, savings associations, farm credit system institutions and credit unions. The Commission exercised this authority at the same time it

<sup>17</sup> CFTC Letter No. 17–67, Re: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52 (Dec. 14, 2017) (“NAL No. 17–67”); CFTC Letter No. 16–80, Re: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52 (Nov. 28, 2016); CFTC Letter No. 15–62, Re: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52 (Nov. 17, 2015); CFTC Letter No. 14–136, Re: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52 (Nov. 7, 2014); CFTC Letter No. 14–26, Time-Limited No-Action Relief from the Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities Not Electing Commission Regulation § 50.52 (Mar. 6, 2014).

<sup>18</sup> 7 U.S.C. 2(h)(8)(B).

<sup>19</sup> 7 U.S.C. 2(h)(7).

<sup>20</sup> 17 CFR 50.50. Among other things, § 50.50 establishes when a swap transaction is considered to hedge or mitigate commercial risk; specifies how to satisfy the reporting requirement; and exempts small financial institutions from the definition of “financial entity.” 17 CFR 50.50.

promulgated the end-user exception final rule.<sup>21</sup>

In contrast to swaps that are eligible for the end-user exception, the Commission's regulations do not specifically exempt from the trade execution requirement swaps that are not subject to the swap clearing requirement based on other statutory authority provisions. Pursuant to its exemptive authority under CEA section 4(c), the Commission promulgated additional exemptions from the clearing requirement for swaps between certain types of entities. Commission regulation 50.51 allows an "exempt cooperative" to elect a clearing exemption for swaps entered into in connection with loans to the cooperative's members.<sup>22</sup> Commission regulation 50.52 provides a clearing exemption for swaps between eligible affiliate counterparties.<sup>23</sup>

At the time of the drafting of the Proposed Rule, the Commission was in the process of considering a proposal to codify certain exemptions from the

<sup>21</sup> On May 12, 2020, the Commission proposed a non-substantive change to § 50.50(d). The Commission proposed to move the exception from the clearing requirement for small banks, loan associations, farm credit system institutions, and credit unions under § 50.50(d) to a stand-alone regulation, namely § 50.53. Swap Clearing Requirement Exemptions, 85 FR 27955, 27962–63 (May 12, 2020). The Commission adopted this proposal on November 2, 2020. See Swap Clearing Requirement Exemptions, 85 FR 76428 (Nov. 30, 2020). Those regulations are now codified in Commission regulation 50.53.

<sup>22</sup> 17 CFR 50.51. The exemption permits a qualifying exempt cooperative to elect not to clear swaps that are executed in connection with originating a loan or loans for the members of the cooperative, or hedging or mitigating commercial risk related to member loans or arising from swaps related to originating loans for members. 17 CFR 50.51(b)(1)–(2).

<sup>23</sup> 17 CFR 50.52. Counterparties have "eligible affiliate counterparty" status if: (i) One counterparty, directly or indirectly, holds a majority ownership interest in the other counterparty, and the counterparty that holds the majority interest in the other counterparty reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles or International Financial Reporting Standards, and such consolidated financial statements include the financial results of the majority-owned counterparty; or (ii) a third party, directly or indirectly, holds a majority ownership interest in both counterparties, and the third party reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles or International Financial Reporting Standards, and such consolidated financial statements include the financial results of both of the swap counterparties. 17 CFR 50.52(a)(1)(i)–(ii). To elect the exemption, such counterparties must also meet additional conditions, including documentation requirements; centralized risk management requirements; reporting requirements; and a requirement to clear outward-facing swaps that are of a type identified in the Commission's clearing requirement (subject to applicable exceptions, exemptions, and alternative compliance frameworks). 17 CFR 50.52(b)–(c).

clearing requirement.<sup>24</sup> The Proposed Rule applied the Commission's section 4(c) exemptive authority to create an explicit exemption from the trade execution requirement for any future exceptions to, or exemptions from, the clearing requirement under part 50.<sup>25</sup>

Proposed § 36.1(c) established an exemption to the trade execution requirement for swap transactions for which an exception or exemption has been elected pursuant to part 50. The Proposed Rule also indicated that the trade execution requirement would not apply to swap transactions for which a future exemption has been adopted by the Commission under part 50.

Proposed § 36.1(e) established a separate exemption from the trade execution requirement that may be elected by eligible affiliate counterparties to a swap submitted for clearing, notwithstanding the eligible affiliate counterparties' option to elect a clearing exemption pursuant to § 50.52. Eligible affiliate counterparties may rely on this exemption from the trade execution requirement regardless of their decision not to elect the inter-affiliate clearing exemption and instead clear the swap.

The Commission has determined that these two exemptions are consistent with the objectives of CEA section 4(c). The following sections address the exemptions in turn.

### *B. Trade Execution Requirement Exemption for Swaps Eligible for a Clearing Requirement Exemption or Exemption Under Part 50*

#### 1. Summary of Comments

The Commission received several comments on the proposed regulations to codify exemptions to the trade execution requirement for swaps that are not subject to the clearing requirement under part 50. JBA expressed support for the proposed

<sup>24</sup> E.g., Swap Clearing Requirement Exemptions, 85 FR 27955 (May 12, 2020) (proposing to exempt from the clearing requirement swaps entered into by central banks, sovereign entities, international financial institutions ("IFIs"), bank holding companies, savings and loan holding companies, and community development financial institutions); Amendments to the Clearing Exemption for Swaps Entered into by Certain Bank Holding Companies, Savings and Loan Holding Companies, and Community Development Financial Institutions, 83 FR 44001 (Aug. 29, 2018). As noted above, the Commission adopted the May 12, 2020 proposal on November 2, 2020. Swap Clearing Requirement Exemptions, 85 FR 76428 (Nov. 30, 2020). See also Proposed Rule at 62038 (discussing the proposed exemption from the clearing requirement for swaps entered by eligible bank holding companies, savings and loan holding companies, and community development financial institutions).

<sup>25</sup> Proposed Rule at 62038.

exemption.<sup>26</sup> Citadel also expressed support for the exemption for swap transactions that are currently subject to a clearing exception or exemption. However, Citadel stated that the Commission should not preemptively grant a trade execution requirement exemption for swaps falling under future clearing exceptions or exemptions, but rather should consider additional future trade execution requirement exemptions on a case-by-case basis.<sup>27</sup> In addition, Citadel recommended that participants be required to actually elect the clearing exemption in order to be eligible for the corresponding exemption from the trade execution requirement.

In addition to the proposed exemptions for swaps not subject to the clearing requirement, Blackrock, ISDA, SIFMA, and GFXD requested an exemption from the trade execution requirement that would apply in instances where a SEF outage or system disruption or limited hours of operation prevent participants from complying with the requirement.<sup>28</sup> Some commenters also requested additional exemptions from the trade execution requirement for block trades and package transactions, such as package transactions that include a futures component.<sup>29</sup> Mercaris separately requested exemptions from the trade execution requirement for swaps that are based on new agricultural assets or have a notional value not exceeding \$5 billion, on the grounds that the Proposed Rule would have an adverse impact on small swaps broking entities due to its expansion of the types of swaps that are subject to the trade execution requirement (to include all swaps that are required to be cleared) as well as the types of entities that are required to register as SEFs (to include trading platforms operated by swaps broking entities).<sup>30</sup>

#### 2. Final Rule: CEA Section 4(c) Authority and Standards

For the purposes of promoting responsible economic or financial

<sup>26</sup> JBA Letter at 4.

<sup>27</sup> Citadel Letter at 40–41.

<sup>28</sup> See Comment Letter from Blackrock at 2 (Mar. 15, 2019) ("Blackrock Letter"); Comment Letter from International Swaps and Derivatives Association, Inc. at 11 (Mar. 15, 2019) ("ISDA Letter"); SIFMA Letter at 14; Comment Letter from the Global Foreign Exchange Division of the Global Financial Markets Association at 5 (Mar. 15, 2019) ("GFXD Letter").

<sup>29</sup> See ISDA Letter at 11, Appendix at 5; SIFMA Letter at 13–14; GFXD Letter at 5–6; Tradeweb Letter at 6; FIA Letter at 15, Comment Letter from Vanguard at 2 (Mar. 15, 2019).

<sup>30</sup> Comment Letter from Mercaris at 1–2 (Mar. 4, 2019) ("Mercaris Letter").

innovation and fair competition,<sup>31</sup> CEA section 4(c) provides the Commission with the authority to exempt any agreement, contract, or transaction from any CEA provision, subject to specified factors. Specifically, the Commission must first determine that (i) the requirement should not be applied to the agreement, contract, or transaction for which the exemption is sought; (ii) the exemption would be consistent with the public interest and the purposes of [the Act]; (iii) the agreement, contract, or transaction at issue will be entered into solely between appropriate persons;<sup>32</sup> and (iv) the agreement, contract, or transaction at issue will not have a material adverse effect on the ability of the Commission or exchange to discharge its regulatory or self-regulatory duties under the Act.<sup>33</sup>

For the reasons stated below, the Commission believes that the trade execution requirement should not be applied to a swap transaction that is eligible for a clearing requirement exception or exemption under part 50, and that the exemption from the trade execution requirement is in the public interest and consistent with the CEA in such circumstances.

The Commission has determined to finalize the exemption largely as proposed, renumbered as § 36.1(b).<sup>34</sup> As

<sup>31</sup> 7 U.S.C. 6(c)(1). CEA section 4(c)(1) is intended to allow the Commission to “provide certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner.” House Conf. Report No. 102–978, 102d Cong. 2d Sess. at 81 (Oct. 2, 1992), *reprinted in* 1992 U.S.C.C.A.N. 3179, 3213.

<sup>32</sup> 7 U.S.C. 6(c)(3). CEA section 4(c)(3) includes a number of specified categories of persons within “appropriate persons” that are deemed as appropriate to enter into swaps exempted pursuant to CEA section 4(c). This includes persons the Commission determines to be appropriate in light of their financial profile or other qualifications, or the applicability of appropriate regulatory protections. As noted below, for purposes of the Final Rule’s section 4(c) exemptions, the Commission has determined that eligible contract participants as defined in CEA section 1a are “appropriate persons.”

<sup>33</sup> 7 U.S.C. 6(c)(2). Notwithstanding the adoption of exemptions from the Act, the Commission emphasizes that their use is subject to the Commission’s anti-fraud and anti-manipulation enforcement authority. In this connection, § 50.10(a) prohibits any person from knowingly or recklessly evading or participating in, or facilitating, an evasion of CEA section 2(h) or any Commission rule or regulation adopted thereunder. 17 CFR 50.10(a). Further, § 50.10(c) prohibits any person from abusing any exemption or exception to CEA section 2(h), including any associated exemption or exception provided by rule, regulation, or order. 17 CFR 50.10(c).

<sup>34</sup> The Commission recently adopted a final rule which adopted an exemption from the trade execution requirement under § 36.1(a) of the Commission’s regulations to establish an exemption to the trade execution requirement for swap transactions that are components of a “New

modified in this adopting release for additional clarity and consistency, § 36.1(b) will apply to any swap transaction that qualifies for the exception under section 2(h)(7) of the Act or an exception or exemption under part 50 of this chapter, and for which the associated requirements are met.<sup>35</sup> As discussed below, applying the trade execution requirement to swaps that are eligible for an exception to or exemption from the clearing requirement, or are otherwise not subject to the clearing requirement, is not consistent with section 2(h)(8) of the CEA and would impose additional burdens on market participants that would be required to incur the costs and burdens of SEF or DCM onboarding and execution. For example, a counterparty that determines not to clear a swap pursuant to a part 50 exemption, but otherwise remains subject to the trade execution requirement, may be limited in where it may trade or execute that swap and subsequently incur costs and operational burdens related to SEF or DCM onboarding and trading. Therefore, the Commission believes swaps that are excepted or exempted from the clearing requirement should also be exempted from the trade execution requirement.

In response to Citadel’s comment that swaps subject to future exemptions from the clearing requirement should not automatically be eligible for an exemption from the trade execution requirement, the Commission notes that Congress expressly chose to link the statutory exemption from the trade execution requirement under CEA section 2(h)(8) to the 2(h)(7) exemption from the clearing requirement. Therefore, as explained elsewhere, the Commission considers it appropriate to follow this statutory intent with respect to the trade execution requirement and recognize that any swaps eligible for an exemption from the clearing requirement should qualify for an exemption from the trade execution requirement. The Commission notes that, consistent with the statutory restrictions on the use of its CEA section 4(c) authority, it has been judicious in issuing clearing exceptions and exemptions, and will continue to be so particularly in light of this linking of clearing exceptions and exemptions with the trade execution exemption.

Issuance Bond” package transaction. *See supra* note 11.

<sup>35</sup> For avoidance of doubt, the Commission makes clear that swap transactions that qualify for a swap clearing requirement exception or exemption under subparts C and D of part 50, and for which the associated requirements are met, are eligible for the exemption from the trade execution requirement under renumbered § 36.1(b).

Additionally, while the Final Rule automatically makes swaps that are eligible for future exemptions from, and exceptions to, the clearing requirement eligible for this exemption from the trade execution requirement, nothing in the Final Rule limits a future Commission’s ability to issue new clearing exemptions or exceptions but still require compliance with CEA section 2(h)(8) by amending this exemption. Given the limited nature of these part 50 exceptions and exemptions, the Commission does not believe that this approach with regard to the trade execution requirement will diminish swaps market transparency or liquidity in a manner likely to implicate systemic risk concerns.

Commenters’ requests for additional exemptions from the trade execution requirement are outside the scope of the current rulemaking. However, the Commission will take these requests under advisement for future rulemakings.<sup>36</sup>

In its comments, Citadel also recommended that participants be required to elect the clearing exemption in order to be eligible for this exemption from the trade execution requirement. The Commission notes that as proposed, renumbered § 36.1(b) required that the appropriate swap clearing requirement exception or exemption be elected in order to be eligible for this exemption. However, since the Proposed Rule, the Commission has adopted exemptions from the swap clearing requirement under part 50 that do not need to be elected, but rather apply by virtue of the status of a counterparty to the transaction.<sup>37</sup> In particular, the swap clearing requirement exemptions for swaps entered into by central banks, sovereign entities, and IFIs apply by virtue of a counterparty’s status as such an entity.

Therefore, the Commission is amending § 36.1(b) to state that section 2(h)(8) of the Act does not apply to a swap transaction that qualifies for an exception under section 2(h)(7) of the Act or one or more of the exceptions or exemptions under part 50 of chapter I of title 17, and for which the associated requirements are met. This amendment will still require, as recommended by Citadel, that, where applicable, the

<sup>36</sup> In addition, the Commission notes that Mercaris grounded its exemption requests on a concern that the Proposed Rule’s expansion of the trade execution and SEF registration requirements would adversely affect small swaps broking entities. Because the Final Rule would not enact either of the changes that Mercaris cited as likely to adversely affect small swaps broking entities, the Commission assumes that Mercaris’ exemption requests are inapplicable to the Final Rule.

<sup>37</sup> *See supra* note 24.

relevant swap clearing requirement exception or exemption be elected in order to be eligible for this exemption. In addition, the amendment also reflects, as discussed above, that there are certain swap clearing requirement exemptions that are not required to be elected. However, the Commission notes that consistent with Citadel's comment, this amendment would still require that all associated requirements of the relevant swap clearing requirement exception or exemption be met in order to be eligible for this exemption.

Under § 36.1(b), swap transactions would still be entered into solely between eligible contract participants ("ECPs"),<sup>38</sup> whom the Commission believes, for purposes of this Final Rule, to be appropriate persons. The scope of this exemption is limited and applies to transactions that are already excepted or exempted from the swap clearing requirement. Further, transactions subject to this exemption are still subject to the Commission's reporting requirements under parts 43 and 45. Therefore, the Commission will still be able to conduct oversight and surveillance of the transactions covered by the exemption. For these reasons, the Commission believes that the exemption would not have a material adverse effect on the ability of the Commission or any SEF or DCM to discharge its regulatory or self-regulatory responsibilities under the CEA and the Commission's regulations.

### C. Trade Execution Exemption for Swaps Between Eligible Affiliate Counterparties

#### 1. Proposed Rule

The Proposed Rule proposed to create a new § 36.1(e) to establish an exemption from the trade execution requirement for swaps between certain affiliates that are submitted for clearing. Counterparties are eligible to elect the exemption if they meet the conditions set forth under § 50.52(a) for "eligible affiliate counterparty" status.<sup>39</sup>

The Commission has previously stated that transactions subject to the inter-affiliate exemption from the swap clearing requirement are exempt from the trade execution requirement.<sup>40</sup> In accordance with time-limited no-action relief granted by Commission staff, counterparties that meet the "eligible

affiliate counterparty" definition under § 50.52(a), but do not claim the inter-affiliate clearing requirement exemption may execute swaps away from a SEF or DCM that are otherwise subject to the trade execution requirement.<sup>41</sup> CFTC staff has granted relief to address the difficulty cited by market participants in executing inter-affiliate swap transactions through the required methods of execution prescribed for swaps subject to the trade execution requirement under § 37.9, *i.e.*, Order Book and RFQ, and subpart J of part 38 of the Commission's regulations. In particular, executing these transactions via competitive means of execution would be difficult because inter-affiliate swaps generally are not intended to be executed on an arm's-length basis or based on fully competitive pricing.<sup>42</sup> Rather, such swaps are used to manage risk among and between affiliates and are subject to internal accounting processes.

In the 2013 rulemaking adopting the inter-affiliate exemption from the clearing requirement, commenters explained that corporate groups often use a single affiliate to face the swap market on behalf of multiple affiliates within the group, which permits the corporate group to net affiliates' trades. This netting effectively reduces the overall risk of the corporate group and the number of open swap positions with external market participants, which in turn reduces operational, market, counterparty credit, and settlement risk.<sup>43</sup> Market participants have asserted that requiring these swap transactions to be executed through a SEF or DCM would impose unnecessary costs and inefficiencies without any of the related benefits associated with competitive means of execution.<sup>44</sup> Accordingly, the Commission sought through the Proposed Rule to provide permanent relief from the trade execution requirement for eligible affiliate counterparties.

#### 2. Summary of Comments

JBA expressed support for the proposed exemption on the grounds that inter-affiliate transactions "do not necessarily seek competitive pricing, but are generally based on intra-group risk management and trading strategies."<sup>45</sup> Citadel generally supported the proposed exemption but recommended that participants be

required to actually elect the clearing exemption in order to be eligible for the corresponding exemption from the trade execution requirement.<sup>46</sup>

#### 3. Final Rule: CEA Section 4(c) Authority and Standard

The Commission believes that exempting an inter-affiliate swap from the trade execution requirement is consistent with the objectives of CEA section 4(c) regardless of whether or not it has been submitted for clearing. For the reasons discussed below, the Commission has determined to finalize this exemption as proposed, renumbered as § 36.1(c).

As noted above, these transactions are not intended to be arm's-length, market-facing, or competitively executed under any circumstance, irrespective of the type of swap involved. Therefore, these transactions would not contribute to the price discovery process if executed on a SEF or a DCM. The statutory purposes of the swaps trading regulatory regime are "to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market."<sup>47</sup> The Commission does not believe that these dual purposes are served by requiring on-SEF trading of swaps that will not contribute to the price discovery process. The Commission therefore agrees with commenters that subjecting these types of transactions to the trade execution requirement confers little if any benefit to the overall swaps market.

The Commission recognizes the efficiency benefits associated with entering into inter-affiliate swaps via internal processes and acknowledges that applying the trade execution requirement to such transactions could inhibit affiliated counterparties from efficiently executing these types of transactions for risk management, operational, and accounting purposes. The Commission therefore believes this trade execution requirement exemption would promote economic and financial innovation by allowing affiliated counterparties to efficiently utilize the risk management approach that best suits their specific needs, including with respect to decisions regarding whether to clear inter-affiliate swaps, without being unduly influenced by whether that choice would require them to execute swaps on a SEF or DCM.

In response to Citadel's comment, the Commission has determined not to require affiliate counterparties to elect the inter-affiliate exemption under § 50.52 in order to claim the

<sup>38</sup> 7 U.S.C. 2(e) (providing that it shall be unlawful for any person, other than an eligible contract participant, to enter into a swap unless the swap is entered into on, or subject to the rules of, a board of trade designated as a contract market).

<sup>39</sup> See *supra* note 23 (describing requirements for meeting "eligible affiliate counterparty" status).

<sup>40</sup> MAT Final Rule, 78 FR 33606, 33606 n. 1 (June 4, 2013).

<sup>41</sup> See *supra* note 17.

<sup>42</sup> See NAL No. 17–67 at 2.

<sup>43</sup> Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750, 21753–54 (Apr. 11, 2013).

<sup>44</sup> NAL No. 17–67 at 2.

<sup>45</sup> JBA Letter at 4.

<sup>46</sup> Citadel Letter at 41.

<sup>47</sup> 7 U.S.C. 7b–3(e) (emphasis added).

concomitant trade execution exemption.<sup>48</sup> Promoting central clearing of standardized swaps is a key objective of the G–20 commitments set out at the 2009 Pittsburgh Summit, as implemented by Section 2(h) of the CEA.<sup>49</sup> A rule requiring counterparties to elect *not* to clear a swap in order to claim a trade execution requirement exemption would frustrate this purpose. Moreover, the Commission finds this exemption appropriate for counterparties that meet the definition of “eligible affiliate counterparty” but decide to clear the swap perhaps because they recognize a benefit from clearing or they do not want to satisfy the other conditions of § 50.52 that are required to elect that exemption from the clearing requirement.

As explained previously, the Commission recognizes the benefits of inter-affiliate swap transactions, including their contributions to efficient risk management within corporate groups. Given that inter-affiliate trades are not executed on a competitive basis and therefore do not contribute to meaningful price discovery, the Commission does not believe that subjecting such transactions to the trade execution requirement would provide any benefit to the swaps markets that would justify the costs and burdens of such a requirement, which may discourage corporate groups from using these transactions as part of an effective risk-management strategy.

For these reasons, the exemption from the trade execution requirement for affiliated counterparties is appropriate and consistent with the public interest and purposes of the CEA. This exemption is limited to transactions between eligible affiliate counterparties. The transactions subject to this exemption are still required to be reported under the Commission’s regulatory reporting requirements under part 45. Therefore, the Commission will still be able to conduct oversight and surveillance of the transactions covered by the exemption. For these reasons, the Commission does not believe that it would have a materially adverse effect on the ability of the Commission or any SEF or DCM to discharge its regulatory

or self-regulatory duties under the CEA. Finally, under the exemption, swap transactions would still be entered into solely between ECPs, whom the Commission believes, for purposes of this Final Rule, to be appropriate persons.

### III. Related Matters

#### A. Regulatory Flexibility Act

The Regulatory Flexibility Act (“RFA”)<sup>50</sup> requires Federal agencies, in promulgating regulations, to consider the impact of those regulations on small businesses. The regulations adopted herein will affect SEFs, DCMs, and ECPs. The Commission has previously established certain definitions of “small entities” to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA.<sup>51</sup> The Commission previously concluded that SEFs and DCMs are not small entities for the purpose of the RFA.<sup>52</sup> The Commission has also previously stated its belief that ECPs<sup>53</sup> as defined in section 1a(18) of the CEA,<sup>54</sup> are not small entities for purposes of the RFA.<sup>55</sup>

As noted above, one commenter, Mercaris, stated that the Proposed Rule would have an adverse impact on small swaps broking entities due to its expansion of the types of swaps that are subject to the trade execution requirement (to include all swaps that are required to be cleared) as well as the types of entities that are required to register as SEFs (to include trading platforms operated by swaps broking entities). Mercaris accordingly requested exemptions from the trade execution requirement for swaps that are based on new agricultural assets or have a notional value not exceeding \$5 billion, and stated that a failure to provide such exemptions would violate the RFA.<sup>56</sup> Because the Final Rule would not adopt either of the changes that Mercaris cited as having an adverse impact on small swaps broking entities, Mercaris’s exemption requests and statements

regarding the RFA are inapplicable to the Final Rule.

Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the regulations will not have a significant economic impact on a substantial number of small entities.

#### B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (“PRA”)<sup>57</sup> imposes certain requirements on Federal agencies (including the Commission) in connection with conducting or sponsoring any “collection of information,”<sup>58</sup> as defined by the PRA. Among its purposes, the PRA is intended to minimize the paperwork burden to the private sector, to ensure that any collection of information by a government agency is put to the greatest possible use, and to minimize duplicative information collections across the government.<sup>59</sup>

The PRA applies to all information, regardless of form or format, whenever the government is obtaining, causing to be obtained, or soliciting information, and includes required disclosure to third parties or the public, of facts or opinions, when the information collection calls for answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons.<sup>60</sup> The PRA requirements have been determined to include not only mandatory, but also voluntary information collections, and include both written and oral communications.<sup>61</sup>

The Final Rule establishes two exemptions from the trade execution requirement. The Final Rule will not create any new, or revise any existing, collections of information under the PRA. Therefore, no information collection request has been submitted to the Office of Management and Budget for review.

#### C. Cost-Benefit Considerations

##### 1. Introduction

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.<sup>62</sup> Section 15(a) further specifies that the costs and

<sup>48</sup> As noted above, the Commission previously determined that swaps for which the counterparties claim the inter-affiliate clearing exemption are not subject to the trade execution requirement. *Supra* note 37 and accompanying text.

<sup>49</sup> See Leaders’ Statement at the Pittsburgh Summit (Sept. 24–25, 2009), available at [https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh\\_summit\\_leaders\\_statement\\_250909.pdf](https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf) (stating that standardized derivatives should be centrally cleared and should be traded on exchanges or electronic trading platforms where appropriate).

<sup>50</sup> 5 U.S.C. 601 *et seq.*

<sup>51</sup> 47 FR 18618–18621 (Apr. 30, 1982).

<sup>52</sup> SEF Core Principles Final Rule, 78 FR 33476, 33548 (June 4, 2013) (citing 47 FR 18618, 18621 (Apr. 30, 1982) (discussing DCMs)); 66 FR 42256, 42268 (Aug. 10, 2001) (discussing derivatives transaction execution facilities, exempt commercial markets, and exempt boards of trade); and 66 FR 45604, 45609 (Aug. 29, 2001) (discussing registered derivatives clearing organizations (“DCOs”)).

<sup>53</sup> 17 CFR 37.703.

<sup>54</sup> 7 U.S.C. 1(a)(18).

<sup>55</sup> 66 FR 20740, 20743 (Apr. 25, 2001) (stating that ECPs by the nature of their definition in the CEA should not be considered small entities).

<sup>56</sup> Mercaris Letter at 1–2.

<sup>57</sup> 44 U.S.C. 3501 *et seq.*

<sup>58</sup> For purposes of this PRA discussion, the terms “information collection” and “collection of information” have the same meaning, and this section will use the terms interchangeably.

<sup>59</sup> 44 U.S.C. 3501.

<sup>60</sup> 44 U.S.C. 3502.

<sup>61</sup> 5 CFR 1320.3(c)(1).

<sup>62</sup> 7 U.S.C. 19(a).

benefits shall be evaluated in light of the following 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.

## 2. Background

The Commission is amending § 36.1 to codify two exemptions from the trade execution requirement for swaps. As noted, the trade execution requirement applies to any swap that is subject to the swap clearing requirement and has been “made available to trade” by a SEF or DCM pursuant to § 37.10 or § 38.12. The first trade execution requirement exemption applies to a swap transaction that qualifies for an exception to, or exemption from, the clearing requirement under part 50 of the Commission’s regulations, and for which the associated requirements are met. The second applies to a swap that is entered into by eligible affiliate counterparties and cleared, regardless of the affiliates’ decision not to claim the inter-affiliate clearing exemption under § 50.52 of the Commission’s regulations and instead clear the swap.

The baseline against which the Commission considers the costs and benefits of this Final Rule is the statutory and regulatory requirements of the CEA and Commission regulations now in effect, in particular CEA section 2(h)(8) and certain rules in part 37 of the Commission’s regulations. The Commission, however, notes that as a practical matter certain market participants, such as eligible affiliates and non-financial end-users, have adopted trade execution practices consistent with this Final Rule based upon statutory provisions or no-action relief provided by Commission staff that is time-limited in nature.<sup>63</sup> As such, to the extent that market participants have relied on statutory provisions to provide an exception from the trade execution requirement or relevant staff no-action relief, the actual costs and benefits of the Final Rule may not be as significant.

In some instances, it is not reasonably feasible to quantify the costs and benefits with respect to certain factors, for example, price discovery or market integrity. Notwithstanding these types of limitations, however, the Commission otherwise identifies and considers the costs and benefits of these rules in qualitative terms. The Commission did not receive any comments from commenters which quantified or

attempted to quantify the costs and benefits of the Proposed Rule.

The following consideration of costs and benefits is organized according to the rules and rule amendments adopted in this release. For each rule, the Commission summarizes the amendments and identifies and discusses the costs and benefits attributable to such rule. The Commission, where applicable, then considers the costs and benefits of the rules in light of the five public interest considerations set out in section 15(a) of the CEA.

The Commission notes that this consideration of costs and benefits is based on the understanding that the swaps market functions internationally, with many transactions involving U.S. firms taking place across international boundaries, with some Commission registrants being organized outside of the United States, with leading industry members typically conducting operations both within and outside the United States, and with industry members commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the discussion of costs and benefits below refers to the effects of the Final Rule on all swaps activity subject to the new and amended regulations, whether by virtue of the activity’s physical location in the United States or by virtue of the activity’s connection with activities in, or effect on, U.S. commerce under CEA section 2(i).<sup>64</sup>

CEA section 2(h)(8) specifies that swap transactions that are excepted from the clearing requirement pursuant to CEA section 2(h)(7) (described in more detail above) are not subject to the trade execution requirement.<sup>65</sup> The Commission adopted requirements under § 50.50 to implement the end-user exception under CEA section 2(h)(7).<sup>66</sup>

The Commission is adopting § 36.1(b) to expressly exempt from the trade execution requirement swaps that are exempt from the clearing requirement

<sup>64</sup> Section 2(i)(1) applies the swaps provisions of both the Dodd-Frank Act and Commission regulations promulgated under those provisions to activities outside the United States that “have a direct and significant connection with activities in, or effect on, commerce of the United States[.]” 7 U.S.C. 2(i). Section 2(i)(2) makes them applicable to activities outside the United States that contravene Commission rules promulgated to prevent evasion of the Dodd-Frank Act.

<sup>65</sup> 7 U.S.C. 2(h)(8)(B).

<sup>66</sup> 17 CFR 50.50. Among other things, § 50.50 establishes when a swap is being used to hedge or mitigate commercial risk and specifies how to satisfy the reporting requirement to elect such an exception from the clearing requirement. 17 CFR 50.50.

pursuant to part 50 of the Commission’s regulations. Part 50 exempts from the clearing requirement swaps that have at least one counterparty that is a certain type of entity, including “exempt cooperatives”, entities that qualify for the statutory end-user exception,<sup>67</sup> and eligible affiliate counterparties.<sup>68</sup> In addition, the Commission recently adopted amendments to part 50 codifying additional clearing exemptions for swaps entered into with certain central banks, sovereign entities, IFIs, bank holding companies, savings and loan holding companies, and community development financial institutions.<sup>69</sup>

## 3. Benefits and Costs

The Final Rule exempts from the trade execution requirement swap transactions between eligible affiliate counterparties that elect to clear such transactions, notwithstanding their ability to elect the clearing exemption under § 50.52. Under the current rules, inter-affiliate transactions are only exempt from the trade execution requirement if the eligible affiliate counterparties elect not to clear the transaction. However, eligible affiliate counterparties that elect to clear their inter-affiliate transactions are not exempted from the trade execution requirement despite these transactions also not being intended to be price forming or arm’s length and therefore may not be suitable for trading on SEFs or DCMs.

Therefore, the Final Rule treats cleared and uncleared inter-affiliate swap transactions the same with respect to the trade execution requirement. The Commission believes that this approach will be beneficial because inter-affiliate swap transactions do not change the ultimate ownership and control of swap positions (or result in netting), and permitting them to be executed internally (provided that they qualify for the clearing exemption under existing § 50.52) may reduce costs relative to requiring that they be executed on a SEF or a DCM. Finally, the Commission believes that this exemption may help ensure that eligible affiliate counterparties are not discouraged from clearing their inter-affiliate swap transactions in order not to have to trade them on SEFs or DCMs subject to the trade execution requirement, which may

<sup>67</sup> This includes the exemption for qualifying banks, savings associations, farm credit system institutions, and credit unions in Commission regulation 50.53.

<sup>68</sup> See *supra* note 23 (describing requirements for meeting “eligible affiliate counterparty” status).

<sup>69</sup> See Swap Clearing Requirement Exemptions, 85 FR 76428 (Nov. 30, 2020).

<sup>63</sup> See NAL No. 17–67.



have systemic risk benefits.<sup>70</sup> Market participants are currently realizing these benefits pursuant to no-action relief and as discussed below, inter-affiliate volume in cleared swaps executed off-exchange appears to be a significant proportion of the overall swap volume that would be subject to the trade execution requirement in fixed-to-floating interest rate swaps (“IRS”).

In an effort to estimate the scope of the Final Rule, Commission staff reviewed swap transaction data for fixed-to-floating IRS for the week ending September 18, 2020. Staff found that approximately \$496 billion notional amount was traded in fixed-to-floating IRS subject to the trade execution requirement (“TER IRS”) during that week.<sup>71</sup> A significant proportion of this volume (approximately \$176 billion notional or 35% of the total) was in swap transactions between eligible affiliate counterparties. Of these inter-affiliate trades, approximately \$96 billion notional was uncleared and approximately \$80 billion notional was cleared. About \$3 billion in swap transactions between eligible affiliate counterparties was cleared and executed on-SEF while the remaining \$77 billion in cleared inter-affiliate transactions in TER IRS was cleared and traded off-exchange pursuant to no-action relief.

The Final Rule also exempts swap transactions that are excepted or exempted from the clearing requirement under part 50 from the trade execution requirement. The Commission believes that swap transactions which are excepted or exempted from the clearing requirement also benefit from exemption from the trade execution requirement, and that the same reasoning that supports the clearing exemptions supports an explicit exemption from the trade execution requirement. The Commission also believes that exempting these transactions from the trade execution requirement is consistent with CEA section 2(h)(8) and adoption of the Final Rule may reduce transaction costs and may permit some entities to avoid incurring the costs associated with onboarding on a SEF or DCM.

The Commission’s staff analysis identified relatively little volume in TER IRS that was marked as being executed by end-users, \$760 million notional of which \$10 million was traded on-SEF and the rest traded off-

exchange. However, it is unclear whether the data captures all the TER IRS trades executed by entities that are trading TER IRS off-exchange pursuant to the no-action relief. In a separate analysis for the recently adopted amendments to part 50, adopting additional clearing exemptions, the Commission found that that final rule exempted only a small fraction of IRS transactions from the clearing requirement.<sup>72</sup> Since only a fraction of IRS transactions are subject to the trade execution requirement, the Commission believes that the scope of swaps subject to this Final Rule is significantly smaller than the scope of swaps subject to the recent amendments to part 50.

The Commission notes that some swap transactions that are subject to the trade execution requirement involving entities that are eligible for existing exemptions (or existing no-action relief) are nevertheless executed on SEFs (as permitted transactions without restrictions on execution method) and all market participants will continue to have the option to execute on SEFs if they determine that they obtain benefits from trading on a SEF voluntarily.

The Commission believes that the exemptions for certain swaps from the trade execution requirement will not impose new costs on market participants or on SEFs and DCMs and, since they are limited in scope and in some instances involve affiliates and thus are not arm’s-length transactions, will not significantly detract from price discovery or protection of market participants and the public.

#### 4. Section 15(a) Factors

##### a. Protection of Market Participants and the Public

The Commission anticipates that the exemptions for certain swaps from the trade execution requirement should not materially affect the protection of market participants and the public. The exemptions finalized today are intended to establish that a limited set of swap transactions which are otherwise subject to the trade execution requirement may occur off-exchange (or on-SEF as permitted transactions). These transactions include inter-affiliate swap transactions and other swap

transactions that are exempt under part 50 from the clearing requirement.

##### b. Efficiency, Competitiveness, and Financial Integrity of the Markets

The Commission anticipates that the exemptions from the trade execution requirement, as discussed above, will maintain the current efficiency of those trades and thus maintain the financial integrity of the counterparties consistent with statutory intent. The Commission believes that the exemptions under part 50 are appropriately tailored and thus, should not materially affect the competitiveness of the swap markets. The Commission does not believe that there would be a benefit to competition in the swap markets if inter-affiliate trades were required to trade on a SEF or on a DCM since these trades merely transfer positions between different entities within the same corporate group.

##### c. Price Discovery

While, as a general matter, the Commission believes that price discovery in swaps subject to the trade execution requirement should occur on SEFs or DCMs, the Commission nevertheless believes that the exemptions from the trade execution requirement should not materially impact price discovery in the U.S. swaps markets. Most of the transactions eligible for the exemptions, such as inter-affiliate trades, are not price forming, while others involve end-users and similar entities.

##### d. Sound Risk Management Practices

The Commission anticipates that the exemptions from the trade execution requirement should not significantly impair the furtherance of sound risk management practices because firms using the exemptions should continue to be able to move swap positions between affiliates, and to take advantage of the statutory end-user exception from the clearing requirement as well as the exemptions from the clearing requirement set forth in part 50. The Commission observes that eligible market participants have been engaging in swaps activity consistent with this Final Rule pursuant to statutory provisions or CFTC staff no-action relief and the practice has not been found to impair risk management practices.

##### e. Other Public Interest Considerations

The Commission has not identified any effects of the rules and the trade execution requirement exemption on other public interest considerations.

<sup>70</sup> The Commission notes that the Division of Market Oversight previously provided no-action relief that mirrors this Final Rule so these benefits may have already been realized. See NAL No. 17–67.

<sup>71</sup> Total volume in fixed-to-floating IRS that week was about \$1.37 trillion notional.

<sup>72</sup> Specifically, the Commission found using DCO data that during calendar year 2018, 16 IFIs entered an estimated notional amount of \$220 billion in uncleared interest rate swaps pursuant to existing no-action relief. During the same time period, eligible bank holding companies and other eligible financial institutions entered an estimated notional amount of \$235 million in uncleared interest rate swaps pursuant to existing no-action relief. See Swap Clearing Requirement Exemptions, 85 FR 76428, 76435 (Nov. 30, 2020).



## 5. Consideration of Alternatives

Commenters were generally supportive of the Proposed Rule and section 4(c) exemptions and recommended only one viable alternative.<sup>73</sup> Specifically, Citadel stated that the Commission should not preemptively grant a trade execution exemption for swaps falling under future clearing exemptions, but rather should consider additional future exemptions from the trade execution requirement on a case-by-case basis. The Commission is finalizing the rule automatically granting such exemptions, and as a consequence will consider the costs and benefits in future rulemakings of both any proposed clearing exemption and the associated exemption from the trade execution requirement. Interested persons will have the opportunity to comment on the appropriateness of both exemptions.

### D. Antitrust Considerations

CEA section 15(b) requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the Act, in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of the Act.<sup>74</sup>

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requested and did not receive comments on whether the Proposed Rule implicates any other specific public interest to be protected by the antitrust laws. The Commission has considered the Final Rule to determine whether it is anticompetitive and has identified no significant anticompetitive effects. Although the Final Rule exempts certain swaps from the requirement to trade competitively on a SEF or DCM, as noted above, these exemptions are narrowly circumscribed in scope, and the Commission has determined the exemptions to be in the public interest. The Commission also notes that the inter-affiliate transactions exempted under new § 36.1(b) would not be executed on a competitive, arm's-length

<sup>73</sup> As discussed above, commenters did recommend several other potential Commission actions that are outside the scope of this rulemaking and are therefore not addressed in this consideration of costs and benefits.

<sup>74</sup> 7 U.S.C. 19(b).

basis even if they were required to occur on a SEF or DCM.

### List of Subjects in 17 CFR Part 36

Trade execution requirement.

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR part 36 as follows:

### PART 36—TRADE EXECUTION REQUIREMENT

■ 1. The authority citation for part 36 continues to read as follows:

**Authority:** 7 U.S.C. 1a, 2, 5, 6, 6c, 7, 7a–2, and 7b–3, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376 (2010).

■ 2. In § 36.1, add paragraphs (b) and (c) to read as follows:

#### § 36.1 Exemptions to trade execution requirement.

\* \* \* \* \*

(b) Section 2(h)(8) of the Act does not apply to a swap transaction that qualifies for the exception under section 2(h)(7) of the Act or an exception or exemption under part 50 of this chapter, and for which the associated requirements are met.

(c) Section 2(h)(8) of the Act does not apply to a swap transaction that is executed between counterparties that have eligible affiliate counterparty status pursuant to § 50.52(a) of this chapter even if the eligible affiliate counterparties clear the swap transaction.

Issued in Washington, DC, on December 23, 2020, by the Commission.

**Christopher Kirkpatrick,**  
*Secretary of the Commission.*

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

### Appendices to Exemptions From Swap Trade Execution Requirement—Commission Voting Summary and Commissioners' Statements

#### Appendix 1—Commission Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

#### Appendix 2—Statement of Concurrence of Commissioner Rostin Behnam

More than two years ago, in November 2018, the Commission voted to propose a comprehensive overhaul of the existing framework for swap execution facilities

(SEFs).<sup>1</sup> Today, the Commission issues two rules finalizing aspects of the SEF Proposal and a withdrawal of the SEF Proposal's unadopted provisions. This is the final step in a long road. Last month, the Commission finalized rules emanating from the SEF Proposal regarding codification of existing no-action letters regarding, among other things, package transactions.<sup>2</sup> Today's final rules and withdrawal complete the Commission's consideration of the SEF Proposal.

Back in November 2018, I expressed concern that finalization of the SEF Proposal would reduce transparency, increase limitations on access to SEFs, and add significant costs for market participants.<sup>3</sup> I also noted that, while the existing SEF framework could benefit from targeted changes, particularly the codification of existing no-action relief, the SEF framework has in many ways been a success. I pointed out that the Commission's work to promote swaps trading on SEFs has resulted in increased liquidity, while adding pre-trade price transparency and competition. Nonetheless, I voted to put the SEF Proposal out for public comment, anticipating that the notice and comment process would guide the Commission in identifying a narrower set of changes that would improve the current SEF framework and better align it with the statutory mandate and the underlying policy objectives shaped after the 2008 financial crisis.<sup>4</sup> More than two years and many comment letters later, that is exactly what has happened. The Commission has been precise and targeted in its finalization of specific provisions from the SEF Proposal that provide needed clarity to market participants and promote consistency, competitiveness, and appropriate operational flexibility consistent with the core principles.

In addition to expressing substantive concerns about the overbreadth of the SEF Proposal, I also voiced concerns that we were rushing by having a comparatively short 75-day comment period.<sup>5</sup> In the end, the comment period was rightly extended, and the Commission has taken the time necessary to carefully evaluate the appropriateness of the SEF Proposal in consideration of its regulatory and oversight responsibilities and the comments received. I think that the consideration of the SEF Proposal is an example of how the process is supposed to work. When we move too quickly toward the finish line and without due consideration of the surrounding environment, we risk making a mistake that will impact our markets and market participants.

Finally, I would like to address the Commission's separate vote to withdraw the

<sup>1</sup> Swap Execution Facilities and Trade Execution Requirement, 83 FR 61946 (Nov. 30, 2018) (the "SEF Proposal").

<sup>2</sup> Swap Execution Facility Requirements (Nov. 18, 2020), <https://www.cftc.gov/PressRoom/PressReleases/8313-20>.

<sup>3</sup> Statement of Concurrence of Commissioner Rostin Behnam Regarding Swap Execution Facilities and Trade Execution Requirement, <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement110518a>.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

unadopted provisions of the SEF Proposal. In the past, I have expressed concern with such withdrawals by an agency that has historically prided itself on collegiality and working in a bipartisan fashion.<sup>6</sup> In the case of today's withdrawal, the Commission has voted on all appropriate aspects of the SEF Proposal through three rules finalized during the past month. The Commission has voted unanimously on all of these rules, including today's decision to withdraw the remainder from further consideration. While normally a single proposal results in a single final rule, in this instance, multiple final rules have been finalized emanating from the SEF Proposal. This could lead to confusion regarding the Commission's intentions regarding the many unadopted provisions of the SEF Proposal. Under such circumstances, I think it is appropriate to provide market participants with clarity regarding the SEF Proposal. Accordingly, I will support today's withdrawal of the SEF Proposal. But rather than viewing it as a withdrawal of the SEF Proposal, I see it as an affirmation of the success of the existing SEF framework and the careful process to markedly improve the SEF framework in a measured and thoughtful way.

### Appendix 3—Statement of Commissioner Dan M. Berkovitz

I support the Commission's decision to withdraw its 2018 proposal to overhaul the regulation of swap execution facilities ("SEFs")<sup>1</sup> ("2018 SEF NPRM") and proceed instead with targeted adjustments to our SEF rules ("Final Rules"). The two Final Rules approved today will make minor changes to SEF requirements while retaining the progress we have made in moving standardized swaps onto electronic trading platforms, which has enhanced the stability, transparency, and competitiveness of our swaps markets.<sup>2</sup>

When the Commission issued the 2018 SEF NPRM, I proposed that we enhance the existing swaps trading system instead of dismantling it. For example, I urged the Commission to clarify the floor trader exception to the swap dealer registration requirement and abolish the practice of post-trade name give-up for cleared swaps. I am pleased that the Commission already has acted favorably on both of those matters. Today's rulemaking represents a further positive step in this targeted approach.

Many commenters to the 2018 SEF NPRM supported this incremental approach, advocating discrete amendments rather than wholesale changes. Today, the Commission is adopting two Final Rules that codify

tailored amendments that received general support from commenters. The first rule—Swap Execution Facilities—amends part 37 to address certain operational challenges that SEFs face in complying with current requirements, some of which are currently the subject of no-action relief or other Commission guidance. The second rule—Exemptions from Swap Trade Execution Requirement—exempts two categories of swaps from the trade execution requirement, both of which are linked to exceptions to or exemptions from the swap clearing requirement.

### Swap Execution Facilities: Audit Trail Data, Financial Resources and Reporting, and Requirements for Chief Compliance Officers

Commission regulations require a SEF to capture and retain all audit trail data necessary to detect, investigate, and prevent customer and market abuses, which currently includes identification of each account to which fills are ultimately allocated.<sup>3</sup> Following the adoption of these regulations, SEFs represented that they are unable to capture post-execution allocation data because the allocations occur away from the SEF, prompting CFTC staff to issue no-action relief. Other parties, including DCOs and account managers, must capture and retain post-execution allocation information and produce it to the CFTC upon request, and SEFs are required to establish rules that allow them obtain this allocation information from market participants as necessary to fulfill their self-regulatory responsibilities. Given that staff is not aware of any regulatory gaps that have resulted from SEFs' reliance on the no-action letter, codifying this alternative compliance framework is appropriate.

This Swap Execution Facility final rule also will amend part 37 to tie a SEF's financial resource requirements more closely to the cost of its operations, whether in complying with core principles and Commission regulations or winding down its operations. Based on its experience implementing the SEF regulatory regime, the Commission believes that these amended resource requirements—some of which simply reflect current practice—will be sufficient to ensure that a SEF is financially stable while avoiding the imposition of unnecessary costs. Additional amendments to part 37, including requirements that a SEF must prepare its financial statements in accordance with U.S. GAAP standards, identify costs that it has excluded in determining its projected operated costs, and notify the Commission within 48 hours if it is unable to comply with its financial resource requirements, will further enhance the Commission's ability to exercise its oversight responsibilities.

Finally, this rule makes limited changes to the Chief Compliance Officer ("CCO") requirements. As a general matter, I agree that the Commission should clarify certain CCO duties and streamline CCO reporting requirements where information is duplicative or not useful to the Commission. Although the CCO requirements diverge

somewhat from those for futures commission merchants and swap dealers, the role of SEFs is different and therefore, standardization is not always necessary or appropriate. I expect that the staff will continue to monitor the effects of all of the changes adopted today and inform the Commission if it believes further changes to our rules are needed.

### Exemptions From Swap Trade Execution Requirement

Commodity Exchange Act ("CEA") section 2(h)(8) specifies that a swap that is excepted from the clearing requirement pursuant to CEA section 2(h)(7) is not subject to the requirement to trade the swap on a SEF. Accordingly, swaps that fall into the statutory swap clearing exceptions (e.g., commercial end-users and small banks) are also excepted from the trading mandate. However, the Commission has also exempted from mandatory clearing swaps entered into by certain entities (e.g., cooperatives, central banks, and swaps between affiliates) using different exemptive authorities from section 2(h)(7).

The Exemptions from Swap Trade Execution Requirement final rule affirms the link between the clearing mandate and the trading mandate for swaps that are exempted from the clearing mandate under authorities other than CEA section 2(h)(7). The additional clearing exemptions are typically provided by the Commission to limited types of market participants, such as cooperatives or central banks that use swaps for commercial hedging or have financial structures or purposes that greatly reduce the need for mandatory clearing and SEF trading. In addition, limited data provided in the release indicates that, at least up to this point in time, these exempted swaps represent a small percentage of the notional amount of swaps traded.

This final rule also exempts inter-affiliate swaps from the trade execution requirement. These swaps are exempted from the clearing requirement primarily because the risks on both sides of the swap are, at least in some respects, held within the same corporate enterprise. As described in the final rule release, these swaps may not be traded at arms-length and serve primarily to move risk from one affiliate to another within the same enterprise. Neither market transparency nor price discovery would be enhanced by including these transactions within the trade execution mandate. For these reasons, I am approving the Exemptions from Swap Trade Execution Requirement final rule as a sensible exemption consistent with the relevant sections of the CEA.

### Conclusion

These two Final Rules provide targeted changes to the SEF regulations based on experience from several years of implementing them. These limited changes, together with the withdrawal of the remainder of the 2018 SEF NPRM, effectively leave in place the basic framework of the SEF rules as originally adopted by the Commission. This framework has enhanced market transparency, improved competition, lowered transaction costs, and resulted in better swap prices for end users. While it

<sup>6</sup>Rostin Behnam, Commissioner, CFTC, Dissenting Statement of Commissioner Rostin Behnam Regarding Electronic Trading Risk Principles (June 25, 2020), <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement062520b>.

<sup>1</sup>Swap Execution Facilities and Trade Execution Requirement, 83 FR 61946 (Nov. 30, 2018).

<sup>2</sup>Dissenting Statement of Commissioner Dan M. Berkovitz Regarding Proposed Rulemaking on Swap Execution Facilities and Trade Execution Requirement (Nov. 5, 2018), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement110518a>.

<sup>3</sup>17 CFR 37.205(a), b(2)(iv).

may be appropriate to make other incremental changes going forward, it is important that we affirm the established regulatory program for SEFs to maintain these benefits and facilitate further expansion of this framework.

I thank the staff of the Division of Market Oversight for their work on these two rules and their helpful engagement with my office.

[FR Doc. 2020-28943 Filed 2-10-21; 8:45 am]

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### Copyright Office

#### 37 CFR Part 210

[Docket No. 2020-7]

#### Treatment of Confidential Information by the Mechanical Licensing Collective and the Digital Licensee Coordinator

**AGENCY:** U.S. Copyright Office, Library of Congress.

**ACTION:** Interim rule.

**SUMMARY:** The U.S. Copyright Office is issuing an interim rule regarding the protection of confidential information by the mechanical licensing collective and the digital licensee coordinator under title I of the Orrin G. Hatch-Bob Goodlatte Music Modernization Act. After soliciting public comments through a notification of inquiry and a notice of proposed rulemaking, the Office is now issuing interim regulations identifying appropriate procedures to ensure that confidential, private, proprietary, or privileged information contained in the records of the mechanical licensing collective and the digital licensee coordinator is not improperly disclosed or used.

**DATES:** Effective March 15, 2021.

#### FOR FURTHER INFORMATION CONTACT:

Regan A. Smith, General Counsel and Associate Register of Copyrights, by email at [regans@copyright.gov](mailto:regans@copyright.gov) or Anna B. Chauvet, Associate General Counsel, by email at [achau@copyright.gov](mailto:achau@copyright.gov). Each can be contacted by telephone at (202) 707-8350.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

On October 11, 2018, the president signed into law the Orrin G. Hatch-Bob Goodlatte Music Modernization Act (“MMA”) which, among other things, substantially modifies the compulsory “mechanical” license for making and distributing phonorecords of nondramatic musical works under 17 U.S.C. 115.<sup>1</sup> It does so by switching

from a song-by-song licensing system to a blanket licensing regime administered by a mechanical licensing collective (“MLC”), which became available on January 1, 2021 (the “license availability date”). In July 2019, the Copyright Office (the “Office”) designated an entity to serve as the MLC, as required by the MMA.<sup>2</sup> Among other things, the MLC is responsible for collecting and distributing royalties under the blanket license, engaging in efforts to identify musical works embodied in particular sound recordings and to identify and locate the copyright owners of such musical works, and administering a process by which copyright owners can claim ownership of musical works (or shares of such works).<sup>3</sup> It also must “maintain the musical works database and other information relevant to the administration of licensing activities under [section 115].”<sup>4</sup> The Office has also designated a digital licensee coordinator (“DLC”) to represent licensees in proceedings before the Copyright Royalty Judges (“CRJs”) and the Office, to serve as a non-voting member of the MLC, and to carry out other functions.<sup>5</sup>

##### A. Regulatory Authority Granted to the Office

The MMA specifically directs the Office to “adopt regulations to provide for the appropriate procedures to ensure that confidential, private, proprietary, or privileged information contained in the records of the mechanical licensing collective and digital licensee coordinator is not improperly disclosed or used, including through any disclosure or use by the board of directors or personnel of either entity, and specifically including the unclaimed royalties oversight committee and the dispute resolution committee of the mechanical licensing collective.”<sup>6</sup> The MMA additionally makes several explicit references to the Office’s regulations governing the treatment of confidential and other sensitive information, including with respect to: (1) “all material records of the operations of the [MLC]”;<sup>7</sup> (2) steps

the MLC must take to “safeguard the confidentiality and security of usage, financial, and other sensitive data used to compute market shares” when distributing unclaimed accrued royalties;<sup>8</sup> (3) steps the MLC and DLC must take to “safeguard the confidentiality and security of financial and other sensitive data shared” by the MLC with the DLC about significant nonblanket licensees;<sup>9</sup> (4) voluntary licenses administered by the MLC;<sup>10</sup> (5) examination of the MLC’s “books, records, and data” pursuant to audits by copyright owners;<sup>11</sup> and (6) examination of digital music providers’ “books, records, and data” pursuant to audits by the MLC.<sup>12</sup>

Beyond these specific directives, Congress invested the Office with “broad regulatory authority”<sup>13</sup> to “conduct such proceedings and adopt such regulations as may be necessary or appropriate to effectuate the provisions of [the MMA pertaining to the blanket license].”<sup>14</sup> The legislative history contemplates that the Office will “thoroughly review[ ]”<sup>15</sup> policies and procedures established by the MLC and its three committees, which the MLC is statutorily bound to ensure are “transparent and accountable,”<sup>16</sup> and promulgate regulations that “balance[ ] the need to protect the public’s interest with the need to let the new collective operate without over-regulation.”<sup>17</sup>

Congress acknowledged that “[a]lthough the legislation provides specific criteria for the collective to operate, it is to be expected that situations will arise that were not contemplated by the legislation,” and that “[t]he Office is expected to use its best judgement in determining the

a period of not less than 7 years after the date of creation or receipt, whichever occurs later.”).

<sup>8</sup> *Id.* at 115(d)(3)(f)(i)(II)(bb).

<sup>9</sup> *Id.* at 115(d)(6)(B)(ii).

<sup>10</sup> *Id.* at 115(d)(11)(C)(iii).

<sup>11</sup> *Id.* at 115(d)(3)(L)(i)(II).

<sup>12</sup> *Id.* at 115(d)(4)(D)(i)(II).

<sup>13</sup> H.R. Rep. No. 115-651, at 5-6 (2018); S. Rep. No. 115-339, at 5 (2018); Report and Section-by-Section Analysis of H.R. 1551 by the Chairmen and Ranking Members of Senate and House Judiciary Committees, at 4 (2018), [https://www.copyright.gov/legislation/mma\\_conference\\_report.pdf](https://www.copyright.gov/legislation/mma_conference_report.pdf) (“Conf. Rep.”).

<sup>14</sup> 17 U.S.C. 115(d)(12)(A).

<sup>15</sup> H.R. Rep. No. 115-651, at 5-6, 14; S. Rep. No. 115-339, at 5, 15; Conf. Rep. at 4, 12. The Conference Report further contemplates that the Office’s review will be important because the MLC must operate in a manner that can gain the trust of the entire music community, but can only be held liable under a standard of gross negligence when carrying out certain of the policies and procedures adopted by its board. Conf. Rep. at 4.

<sup>16</sup> 17 U.S.C. 115(d)(3)(D)(ix)(I)(aa).

<sup>17</sup> H.R. Rep. No. 115-651, at 5-6, 14; S. Rep. No. 115-339, at 5, 15; Conf. Rep. at 4, 12.

<sup>2</sup> 84 FR 32274 (July 8, 2019).

<sup>3</sup> 17 U.S.C. 115(d)(3)(C)(i)(V).

<sup>4</sup> *Id.* at 115(d)(3)(C)(i)(IV).

<sup>5</sup> *Id.* at 115(d)(5)(B); 84 FR 32274 (July 8, 2019); see also 17 U.S.C. 115(d)(3)(D)(i)(IV), (d)(5)(C).

<sup>6</sup> 17 U.S.C. 115(d)(12)(C).

<sup>7</sup> *Id.* at 115(d)(3)(M)(i) (“The mechanical licensing collective shall ensure that all material records . . . are preserved and maintained in a secure and reliable manner, with appropriate commercially reasonable safeguards against unauthorized access, copying, and disclosure, and subject to the confidentiality requirements prescribed by the Register of Copyrights under paragraph (12)(C) for

<sup>1</sup> Public Law 115-264, 132 Stat. 3676 (2018).