

Staff Guidance – Information Regarding Foreign Regulatory Requirements for Substituted Compliance Applications

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The information set forth below is not intended to be exhaustive, and the necessary contents of applications for substituted compliance may vary depending on the applicable facts and circumstances.

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Background

Rule 3a71-6 under the Securities Exchange Act of 1934 (“Exchange Act”) provides that a registered non-U.S. security-based swap dealer or major security-based swap participant may satisfy certain requirements under Exchange Act section 15F by complying with comparable regulatory requirements of a foreign jurisdiction.¹ The rule particularly provides that substituted compliance potentially is available in connection with the requirements related to business conduct and supervision, chief compliance officers, trade acknowledgment and verification, capital, margin, recordkeeping and reporting, and risk mitigation.²

Rule 3a71-6 conditions substituted compliance in part on the Commission determining that the foreign requirements are comparable to the otherwise applicable requirements, after taking into account “such factors as the Commission determines are appropriate,” such as “the scope and objectives of the relevant foreign regulatory requirements” and “the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by the foreign financial regulatory authority.”³

¹ At times this guidance will refer to security-based swap dealers as “dealers,” and refer to major security-based swap participants as “major participants.”

² Exchange Act rule 3a71-6(d) [17 CFR 240.3a71-6(d)].

Separately, substituted compliance potentially is available in connection with regulatory reporting and public dissemination requirements. *See* Regulation SBSR rule 908(c) [17 CFR 242.908(c)]. This guidance does not address applications for substituted compliance in connection with those requirements.

³ Exchange Act rule 3a71-6(a)(2)(i) [17 CFR 240.3a71-6(a)(2)(i)].

Rule 3a71-6 also conditions substituted compliance on the Commission entering into a supervisory and enforcement memorandum of understanding and/or other arrangement with the relevant foreign financial regulatory authority or authorities addressing supervisory and

Exchange Act rule 0-13 governs applications for substituted compliance. Among other things, rule 0–13 provides that applications must include supporting documents necessary to make the application complete, “including information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor and enforce compliance with such rules.”⁴ Rule 0–13 further provides that Commission staff will review the application after the filing is complete, and that the Commission shall publish a notice that a completed application has been submitted.⁵

Holistic focus on regulatory outcomes

The Commission has explained that substituted compliance does not constitute exemptive relief or excuse registered entities from having to comply with Exchange Act requirements, but instead provides an alternative method of satisfying those requirements.⁶ To implement substituted compliance, the Commission will “endeavor to take a holistic approach in considering whether regulatory requirements are comparable for purposes of substituted compliance, and will focus on the comparability of regulatory outcomes rather than predicating substituted compliance on requirement-by-requirement similarity.”⁷

The Commission further recognizes that “different regulatory systems may be able to achieve some or all of those regulatory outcomes by using more or fewer specific requirements than the Commission, and that in assessing comparability the Commission may need to take into account the manner in which other regulatory systems are informed by business and market practices in those jurisdictions.”⁸ Because the comparability assessments will focus on regulatory outcomes rather than requirement-by-requirement similarity, the assessments “will require inquiry regarding whether foreign regulatory requirements adequately reflect [the relevant] interests and protections.”⁹

enforcement cooperation and other matters arising under the substituted compliance determination. *See* Rule 3a71-6(a)(2)(ii) [17 CFR 240.3a71-6(a)(2)(ii)].

⁴ Exchange Act rule 0-13(e) [17 CFR 240.0-13(e)].

⁵ Exchange Act rule 0-13(g), (h) [17 CFR 240.0-13(g), (h)].

⁶ *See* Exchange Act Release No. 77617 (Apr. 14, 2016), 81 FR 29960, 30074 (May 13, 2016) (“Business Conduct Adopting Release”).

⁷ *See id.* at 30078.

⁸ *See id.*

⁹ *See id.* This inquiry potentially will account for whether the Exchange Act sets forth relevant requirements with specificity, or whether the requirements at issue are the product of less specific Exchange Act provisions or of general statutory grants of authority to the Commission. In doing so, the analysis may place special emphasis on the foreign regime’s comparability with requirements that are set forth by the Exchange Act with a heightened degree of specificity – *e.g.*, required disclosure of certain risks, characteristics, incentives and conflicts (Exchange Act section 15F(h)(3)(B)(i), (ii) [15 U.S.C. 78o-10(h)(3)(B)(i), (ii)]); required disclosure of daily marks (Exchange Act section 15F(h)(3)(B)(iii) [15 U.S.C. 78o-10(h)(3)(B)(iii)]); fair and balanced communications requirements (Exchange Act section 15F(h)(3)(C) [15 U.S.C. 78o-

Information in substituted compliance applications

To facilitate complete applications that will permit informed assessments, this guidance poses questions for applicants to consider regarding the regulatory interests reflected in the relevant foreign requirements, and asks how those are comparable to the interests associated with the analogous requirements under the Exchange Act. This guidance also summarizes the relevant Exchange Act requirements to help applicants understand the contours of those requirements, and facilitate applications that adequately explain how relevant foreign requirements produce comparable outcomes to Exchange Act requirements.

To facilitate applications that analyze whether holistic regulatory outcomes are achieved, this guidance groups the relevant requirements by the following categories:

- I. Risk control – encompassing capital, margin, risk management system, trade acknowledgment and verification, portfolio reconciliation, portfolio compression and trading relationship documentation requirements.
- II. Recordkeeping and reporting – encompassing record creation, record maintenance, reporting and notice requirements.
- III. Internal supervision and compliance – encompassing supervision, conflict of interest and chief compliance officer requirements.
- IV. Counterparty protection – encompassing requirements related to: fair and balanced communications; disclosure of certain risks, characteristics, incentives and conflicts; daily mark disclosure; “know your counterparty”; suitability of recommendations; and disclosure of clearing rights.
- V. Additional requirements regarding eligible contract participant verification, special entities and political contributions.

Applications may request substituted compliance for any – or all – of the individual requirements within the above groupings. Applications may analyze foreign requirements’ consistency with outcomes related to individual Exchange Act requirements or, as appropriate, may account for the foreign requirements’ consistency with the broader outcomes associated with relevant categories of requirements (*e.g.*, the foreign requirements’ consistency with the “counterparty protection” requirements as a whole).

The guidance below is intended to serve as a starting point for applicants to provide information regarding the requirements of the foreign regime that is relevant to determining whether those requirements produce regulatory outcomes that are comparable with the relevant Exchange Act requirements. The Staff may request additional information regarding applicable requirements.

Note on the effectiveness of supervisory and enforcement regimes

As noted above, the Commission must also take into account the effectiveness of the foreign supervisory program and the effectiveness of the exercise of foreign enforcement authority when determining whether to grant substituted compliance. This guidance does not address those

10(h)(3)(C)); and chief compliance officer requirements (Exchange Act section 15F(k) [15 U.S.C. 78o-10(k)]).

issues. Instead, given the variety of supervisory and enforcement regulatory frameworks across jurisdictions, parties interested in seeking substituted compliance are encouraged to contact Commission staff to discuss the information they should provide to the Commission regarding their jurisdiction's supervisory and enforcement framework.

I. Risk control requirements

The risk control requirements of the Exchange Act promote market stability by requiring that registered entities have adequate financial resources and follow risk mitigation and documentation practices that are appropriate to manage the market, counterparty, operational and legal risks associated with their security-based swap business.¹⁰ These entity-level requirements

¹⁰ In proposing requirements related to capital, margin and risk management systems, the Commission noted that the objective of the capital standards for nonbank dealers is to “protect customer assets and mitigate the consequences of a firm failure,” while allowing firms flexibility in conducting their security-based swap business. *See* Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70214, 70218 (Nov. 23, 2012); *see also id.* at 70230 (adding that the objective of the proposed capital requirements is to require nonbank dealers to maintain sufficient liquidity such that if they fail they can “meet all unsubordinated obligations to customers and counterparties and have adequate resources to wind-down in an orderly manner without the need for a formal proceeding”). As part of that proposal, the Commission further recognized that the Dodd-Frank Act seeks to address the risk of uncollateralized credit risk exposure arising from over-the-counter derivatives in part by mandating margin requirements for non-cleared security-based swaps and swaps. *See id.* at 70258.

The Commission also noted that “[p]rudent financial institutions establish and maintain integrated risk management systems that seek to have in place management policies and procedures designed to help ensure an awareness of, and accountability for, the risks taken throughout the firm and to develop tools to address those risks.” *See id.* at 70250.

Separately, in adopting trade acknowledgement and verification requirements, the Commission noted that that the rule was intended to avoid recurrences of documentation backlogs, and address concerns regarding the documentation of credit derivatives. The Commission further stated that the rule “was intended to reduce the risk a court may have to supply contract terms upon which there was no previous agreement,” adding that unconfirmed trades could allow errors to go undetected that might subsequently lead to losses and other problems, such as firms inaccurately measuring and managing their risk exposures, which may contribute to broader market problems. The Commission added that if security-based swap transactions are not “reduced to writing, there is no definitive written record of the contract terms to which the counterparties have agreed, which can lead to legal and operational risk for market participants.” Exchange Act Release No. 78011 (Jun. 8, 2016), 81 FR 39808, 39809 (Jun. 17, 2019) (“Trade Acknowledgment and Verification Adopting Release”).

In adopting the portfolio reconciliation, portfolio compression and trading relationship documentation requirements, the Commission noted that “portfolio reconciliation could help to mitigate the possibility of a discrepancy unexpectedly affecting performance under the security-based swap transaction by increasing the likelihood that the parties are and remain in agreement with respect to all material terms,” and that “valuation discrepancies identified during reconciliation could help to identify problems with one or both of the counterparties’ internal valuation systems and models, or possibly even with a firm’s internal controls.” *See* Exchange Act Release No. 87782 (Dec. 18, 2019) at 10-11 (“Risk Mitigation Adopting Release”). The Commission further stated that compression may reduce a market participant’s “gross exposure to its direct counterparties, including by eliminating all exposure to certain counterparties,” and may provide “important operational benefits and efficiencies for market participants in that there are fewer open contracts to manage, maintain, and settle, resulting in fewer opportunities for processing errors, failures, or other problems that could develop throughout the lifecycle of a transaction.” *Id.* at 12-13. In addition, the Commission expressed the view that requiring trading

generally apply to the entirety of a firm’s business, regardless of the location of the business or counterparty.

These consist of the following requirements:¹¹

- *Capital* – as provided by Exchange Act section 15F(e) [15 U.S.C. 78o-10(e)] and Exchange Act rules 18a-1, 18a-1a, 18a-1b, 18a-1c, 18a-1d and 18a-2 [17 CFR 240.18a-1, 240.18a-1a, 240.18a-1b, 240.18a-1c, 240.18a-1d and 240.18a-2].¹²
- *Margin* – as provided by Exchange Act section 15F(e) [15 U.S.C. 78o-10(e)] and Exchange Act rule 18a-3 [17 CFR 240.18a-3].
- *Risk management systems* – as provided by Exchange Act section 15F(j)(2) [15 U.S.C. 78o-10(j)(2)] and Exchange Act rules 15Fh-3(h)(2)(iii)(I), 18a-1(f) and 18a-2(c) [17 CFR 140.15Fh-3(h)(2)(iii)(I), 240.18a-1(f) and 240.18a-2(c)].
- *Trade acknowledgment and verification* – as provided by Exchange Act section 15F(i) [15 U.S.C. 78o-10(i)] and Exchange Act rule 15Fi-2 [17 CFR 240.15Fi-2].
- *Portfolio reconciliation, portfolio compression and trading relationship documentation* – as provided by Exchange Act section 15F(i) [15 U.S.C. 78o-10(i)] and Exchange Act rules 15Fi-3, 4 and 5 [17 CFR 240.15Fi-3, 4 and 5].¹³

Some entities subject to the Exchange Act’s capital, margin and risk management requirements (as well as certain books and records addressed below) may be able to comply with an alternative

relationship documentation “should promote sound collateral and risk management practices by enhancing transparency and legal certainty regarding each party’s rights and obligations under the transaction,” which “should help to reduce counterparty credit risk and promote certainty regarding the agreed-upon valuation and other material terms of a security-based swap.” *Id.* at 14.

¹¹ For further information regarding these requirements regarding capital, margin and risk management systems, *see generally* Exchange Act Release No. 86175 (Jun. 21, 2019), 84 FR 43872, 43949 (Aug. 22, 2019) (“Capital and Margin Adopting Release”). For further information regarding the trade acknowledgment and verification requirements, *see generally* Trade Acknowledgment and Verification Adopting Release and Risk Mitigation Adopting Release, note 10, *supra*.

¹² The Commission’s capital and margin rules (including certain of the risk management system rules addressed below), apply only to security-based swap dealers and major security-based swap participants that do not have a prudential regulator. The prudential regulators are responsible for capital and margin rules applicable to dealers and major participants that are banks. *See* Exchange Act section 15F(e) [15 U.S.C. 78o-10(e)].

¹³ In adopting substituted compliance rules related to capital and margin requirements (including risk management system rules), trade acknowledgment and verification requirements, and portfolio reconciliation, portfolio compression and trading relationship documentation requirements, the Commission noted that the comparability assessments related to those requirements may constitute part of a broader assessment of the foreign regulatory system’s risk mitigation requirements, and the applicable comparability assessments may be conducted at the level of those risk mitigation requirements as a whole. *See* Capital and Margin Adopting Release, 84 FR at 43949; Trade Acknowledgment and Verification Adopting Release, 81 FR at 39828, Risk Mitigation Adopting Release at 88.

compliance mechanism based on compliance with certain requirements adopted pursuant to the Commodity Exchange Act.¹⁴ Foreign entities that may need to register with the Commission as security-based swap dealers may wish to evaluate whether they would qualify to operate under this alternative compliance mechanism.

A. Criteria for assessing comparability

Consistent with the holistic approach toward assessing the comparability of regulatory outcomes in connection with substituted compliance, the comparability assessment associated with these requirements may focus on the comparability of individual requirements or, alternatively, may focus on whether the analogous requirements of a foreign jurisdiction – taken as a whole – produce similar outcomes as Exchange Act requirements with regard to the overall goal of providing that registered entities have financial resources and follow risk mitigation and documentation practices that are appropriate to the market, counterparty, operational and legal risks associated with their security-based swap business. This latter approach does not require that the foreign jurisdiction have analogues to every requirement under Commission rules as long as the overall requirements of a foreign jurisdiction provide similar regulatory outcomes.

Moreover, Exchange Act rule 3a71-6(d)(4)(i) [17 CFR 240.3a71-6(d)(4)(i)] provides that when making substituted compliance determinations in connection with security-based swap dealer capital requirements, the Commission intends to consider (in addition to any conditions imposed) “whether the capital requirements of the foreign financial regulatory system are designed to help ensure the safety and soundness of registrants in a manner that is comparable to the applicable provisions arising under the [Exchange Act] and its rules and regulations.”¹⁵

Rule 3a71-6(d)(5)(i) [17 CFR 240.3a71-6(d)(5)(i)] provides that when considering substituted compliance in connection with security-based swap dealer margin requirements, the Commission

¹⁴ See Exchange Act rule 18a-10 [17 CFR 240.18a-10]. Under this alternative compliance mechanism, certain security-based swap dealers that also are registered with the Commodity Futures Trading Commission (“CFTC”) as swap dealers, and that predominantly engage in a swaps business, may elect to comply with the capital, margin, segregation, recordkeeping and reporting requirements of the Commodity Exchange Act (“CEA”) and the CFTC’s rules in lieu of complying with the SEC’s analogous security-based swap dealer requirements. To take advantage of the alternative compliance mechanism, the security-based swap dealer cannot be registered as a broker-dealer (including as an OTC derivatives dealer), and the aggregate gross notional amount of the firm’s security-based swap positions must not exceed the lesser of a maximum fixed-dollar amount or 10 percent of the combined aggregate gross notional amount of the firm’s security-based swap and swap positions.

This alternative compliance mechanism does not apply to trade acknowledgment and verification requirements.

¹⁵ For major security-based swap participants, the rule more generally states that the Commission intends to consider (in addition to any conditions imposed) whether the capital requirements of the foreign financial regulatory system are comparable to the applicable provisions arising under the Exchange Act and its rules and regulations. See Exchange Act rule 3a71-6(d)(4)(ii) [17 CFR 240.3a71-6(d)(4)(ii)].

Certain of the risk management control system rules discussed below (*see* note 64, *infra*, and accompanying text), were adopted as part of the capital rules.

intends to consider (in addition to any conditions imposed) “whether the foreign financial regulatory system requires registrants to adequately cover their current and potential future exposure to over-the-counter derivatives counterparties, and ensures registrants’ safety and soundness, in a manner comparable to the applicable provisions” arising under the Exchange Act and its underlying rules and regulations.¹⁶

Exchange Act rule 3a71-6(d)(3) [17 CFR 240.3a71-6(d)(3)] provides that when considering substituted compliance in connection with trade acknowledgment and verification requirements the Commission intends to consider whether “the information that is required to be provided pursuant to the requirements of the foreign financial regulatory system, and the manner by which that information must be provided,” are comparable to those required pursuant to the applicable Exchange Act provisions and underlying rules.

Finally, Exchange Act rule 3a71-6(d)(7) [17 CFR 240.3a71-6(d)(7)] provides that when considering substituted compliance in connection with portfolio reconciliation, portfolio compression and trading relationship documentation requirements the Commission intends to consider whether “the requirements of the foreign financial regulatory system for engaging in portfolio reconciliation and portfolio compression and for executing trading relationship documentation with counterparties, the duties imposed by the foreign financial regulatory system, and the information that is required to be provided to counterparties pursuant to the requirements of the foreign financial regulatory system” are comparable to those required pursuant to the applicable Exchange Act provisions and underlying rules.

B. Capital requirements for nonbank firms

The risk control requirements in part address the required levels of capital that registered entities must maintain to help ensure that, in the event of firm failure, there are resources sufficient to wind down the business in an orderly manner that protects counterparties and avoids contributing to market disruptions.

Your jurisdiction’s requirements

Relevant information for the discussion regarding your jurisdiction’s capital requirements for applicable nonbank firms may include (along with other relevant factors):

- How does your jurisdiction establish minimum capital requirements?
- What are the legal consequences if a firm falls below the minimum capital requirements? Does your jurisdiction require that a firm cease conducting business if its capital falls below the required minimum?¹⁷

¹⁶ For major participants, the rule states that the Commission intends to consider (in addition to any conditions imposed) current exposure (variation margin). The rule does not address potential future exposure (initial margin). See Exchange Act rule 3a71-6(d)(5)(ii) [17 CFR 240.3a71-6(d)(5)(ii)].

¹⁷ As context, Exchange Act rule 18a-1 provides that every registered security-based swap dealer at all times must have and maintain net capital in excess of the applicable minimum requirements. Otherwise, the firm must immediately cease conducting business as a security-based swap dealer.

- How effective is the level of capital required of applicable nonbank firms under your jurisdiction’s approach with respect to helping ensure that the liquidation of a firm will not result in excessive delay in repayment of the firm’s obligations to security-based swap customers and creditors, therefore assuring the continued market liquidity?
- To what extent do the required capital levels for nonbank firms in your jurisdiction reflect regulatory concerns that differ from the concerns that underpin Exchange Act rule 18a-1?¹⁸ Do any differences in the regulatory concerns that underpin your jurisdiction’s required capital levels lead to different regulatory outcomes from those attained under the Exchange Act? If so, are there any conditions that could be applied to substituted compliance to promote comparable regulatory outcomes, notwithstanding differences in the underlying concerns?

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

The Exchange Act, in part, provides that to “offset the greater risk” to security-based swap dealers, major security-based swap participants and the financial system arising from the use of uncleared security-based swaps, the applicable capital and margin requirements shall: (i) “help ensure the safety and soundness” of the security-based swap dealer or major security-based swap participant; and (ii) “be appropriate for the risk associated with” uncleared security-based swaps held by the security-based swap dealer or major security-based swap participant.¹⁹

Under Commission rules applicable to nonbank security-based swap dealers that are not also registered broker-dealers.²⁰

¹⁸ As background, the Exchange Act rule 18a-1 capital requirement (applicable to security-based swap dealers that are not also registered broker-dealers) is grounded in the net liquid asset test applicable to registered-broker dealers. The net liquid asset test seeks to promote liquidity by requiring that firms maintain sufficient liquid assets to meet their liabilities, and, in the event of firm failure, to have adequate additional resources to wind-down the business in an orderly manner without the need for a formal proceeding. *See* Capital and Margin Adopting Release, 84 FR at 43879.

¹⁹ Exchange Act section 15F(e)(3)(A) [15 U.S.C. 78o-10(e)(3)(A)].

²⁰ Exchange Act rule 18a-1 [17 CFR 240.18a-1] sets forth net capital rules applicable to security-based swap dealers, including security-based swap dealers that are OTC derivatives dealers (as defined in Exchange Act rule 3b-12 [17 CFR 240.3b-12]), that are not also broker-dealers. Security-based swap dealers that also are broker-dealers are subject to the broker-dealer net capital requirements of Exchange Act rule 15c3-1 [17 CFR 240.15c3-1] and its appendices. Substituted compliance is not available in connection with broker-dealer requirements.

- Nonbank security-based swap dealers that do not use models to compute market and credit risk deductions must at all times have and maintain net capital of not less than the greater of \$20 million or two percent of the risk margin amount.²¹
- Nonbank security-based swap dealers that are permitted to use models to compute market and credit risk deductions must at all times maintain tentative net capital of not less than \$100 million, along with net capital of not less than the greater of \$20 million or two percent of the risk margin amount.²²
- Nonbank security-based swap dealers must maintain additional net capital, over the above amounts, in connection with certain instruments subject to reverse repurchase agreements.²³

To calculate “tentative net capital,” a firm’s net worth (under U.S. generally accepted accounting principles) is subject to a number of adjustments.²⁴ That amount then is subject to further adjustments to calculate “net capital.”²⁵

Calculation of “tentative net capital” particularly requires adjustments to a firm’s net worth related to: unrealized profits/losses and deferred tax liabilities,²⁶ subordinated liabilities,²⁷ assets

²¹ Exchange Act rule 18a-1(a)(1) [17 CFR 240.18a-1(a)(1)]. That risk margin amount percentage is subject to future increases by Commission order. *See* Exchange Act rule 18a-1(a)(1)(i)(B), (C) and (a)(1)(ii) [17 CFR 240.18a-1(a)(1)(i)(B), (C) and (a)(1)(ii)].

For these purposes, “risk margin amount” means the sum of: (i) the total initial margin the dealer is required to maintain at each clearing agency with respect to security-based swap transactions cleared for security-based swap customers; plus (ii) the total initial margin associated with non-cleared security-based swaps, as calculated pursuant to Exchange Act 18a-3. Exchange Act rule 18a-1(c)(6) [17 CFR 240.18a-1(c)(6)].

²² Exchange Act rule 18a-1(a)(2) [17 CFR 240.18a-1(a)(2)]. That risk margin amount percentage similarly is subject to future increases by Commission order. *See* Exchange Act rule 18a-1(a)(2)(i)(B), (C) and (a)(1)(ii) [17 CFR 240.18a-1(a)(2)(i)(B), (C) and (a)(1)(ii)].

²³ Exchange Act rule 18a-1(b) [17 CFR 240.18a-1(b)].

²⁴ Exchange Act rule 18a-1(c)(5) [17 CFR 240.18a-1(c)(5)].

²⁵ Exchange Act rule 18a-1(c)(1) [17 CFR 240.18a-1(c)(1)].

²⁶ Exchange Act rule 18a-1(c)(1)(i) [17 CFR 240.18a-1(c)(1)(i)]. This provision requires adjustments to reflect unrealized profits and losses in the dealer’s account, and to add certain amounts related to deferred income tax liability. The provision also addresses the valuation of options positions for purposes of calculating net worth.

²⁷ Exchange Act rule 18a-1(c)(1)(ii) [17 CFR 240.18a-1(c)(1)(ii)]. This provision requires the exclusion of certain subordinated liabilities.

not readily convertible into cash,²⁸ non-marketable securities,²⁹ “failed to deliver” contracts,³⁰ undermargined accounts,³¹ and deductions in lieu of collecting collateral for non-cleared transactions.³²

Calculation of “net capital” requires further adjustments (to “tentative net capital”) related to: standardized haircuts on security-based swaps and swaps,³³ standardized haircuts on other

²⁸ Exchange Act rule 18a-1(c)(1)(iii) [17 CFR 240.18a-1(c)(1)(iii)]. This provision requires the deduction of assets that cannot readily be converted into cash.

Those assets include, *inter alia*: (A) fixed assets; (B) certain unsecured and partially secured receivables (*e.g.*, deficits in customer and non-customer secured and partly secured accounts after application of calls for margin); (C) insurance claims; (D) other deductions such as other unsecured receivables, and all assets doubtful of collection (less associated reserves); (E) certain deductions associated with repurchase and reverse repurchase agreements; (F) certain securities borrowed (where the deduction equals one percent of market value of securities borrowed collateralized by an irrevocable letter of credit); and (G) certain receivables from an affiliate and collateral given to an affiliate (other than affiliates registered in certain capacities).

²⁹ Exchange Act rule 18a-1(c)(1)(iv) [17 CFR 240.18a-1(c)(1)(iv)]. In general, this provision requires the deduction of 100 percent of the carrying value of certain instruments for which there is no ready market, and of securities that cannot be publicly offered or sold due to statutory, regulatory or contractual arrangements or other restrictions. Per Exchange Act rule 18a-1(c)(5) [17 CFR 240.18a-1(c)(5)], however, securities for which there is no ready market do not have to be deducted when calculating tentative net capital if the firm has been approved to use models to calculate market risk.

³⁰ Exchange Act rule 18a-1(c)(1)(v) [17 CFR 240.18a-1(c)(1)(v)]. This provision requires the deduction of certain amounts in connection with “failed to deliver” contracts.

³¹ Exchange Act rule 18a-1(c)(1)(viii) [17 CFR 240.18a-1(c)(1)(viii)]. This provision requires the deduction of amounts required in swap and security-based swap customer accounts to meet applicable margin requirements.

³² Exchange Act rule 18a-1(c)(1)(ix) [17 CFR 240.18a-1(c)(1)(ix)]. This provision requires the deduction of certain amounts when the dealer elects not to collect margin from swap and security-based swap counterparties in connection with non-cleared transactions that are subject to an exception in applicable margin rules. The provision further provides that collateral held at a third party custodian may be considered to be held in the counterparty’s account at the dealer under certain conditions. *See* Exchange Act rule 18a-1(c)(1)(ix)(C) [17 CFR 240.18a-1(c)(1)(ix)(C)].

³³ Exchange Act rules 18a-1(c)(1)(vi) and 18a-1b [17 CFR 240.18a-1(c)(1)(vi), 240.18a-1b]. This provision requires the deduction of certain amounts in connection with security-based swaps and swaps held in a dealer’s proprietary account.

For cleared security-based swaps held in the dealer’s proprietary account, the deduction would equal the clearing agency’s margin requirement, except that if the security-based swap references an equity security, the dealer may take a deduction using the method specified in Exchange Act rule 18a-1a. *See* Exchange Act rule 18a-1(c)(1)(vi)(A) [17 CFR 240.18a-1(c)(1)(vi)(A)].

For non-cleared security-based swaps, the amount of the deduction is addressed via a number of circumstance-specific rules. *See* Exchange Act rule 18a-1(c)(1)(vi)(B) [17 CFR 240.18a-1(c)(1)(vi)(B)] (prescribing haircuts that address various circumstances involving non-cleared credit defaults swap and other security-based swaps).

securities, money market instruments and options,³⁴ and model-based market risk and credit risk deductions.³⁵

Nonbank security-based swap dealers may apply to the Commission for authorization to use models to compute deductions for market risk and credit risk in lieu of applying certain of the deductions above.³⁶

Nonbank major security-based swap participants (that are not also broker-dealers) are required to have and maintain positive tangible net worth.³⁷

C. Margin requirements for nonbank firms

The risk control requirements in part address the margin practices that registered entities must follow to help ensure that counterparty default does not impair the registered entity, and more generally to help ensure that default does not result in wider issues within the market.³⁸

Your jurisdiction's requirements

Relevant information for the discussion regarding your jurisdiction's margin requirements for applicable nonbank firms may include (along with other relevant factors):

- To what extent are models permitted for calculating calculate initial margin? What are the minimum standards required of acceptable models (*e.g.*, required confidence levels and restrictions on the use of models in connection with equity security-based swaps)?

³⁴ Exchange Act rule 18a-1(c)(1)(vii) [17 CFR 240.18a-1(c)(1)(vii)]. For securities, money market instruments and options in the dealer's proprietary account, this addresses the deduction of certain percentages specified in the broker-dealer net capital rule.

³⁵ For firms that are permitted to use models to calculate market risk and credit risk deductions (as discussed below), these adjustments address model-based alternatives to the standardized haircuts and credit risk amounts that would apply otherwise. Per Exchange Act rule 18a-1(c)(5) [17 CFR 240.18a-1(c)(5)], those model-based market risk and credit risk amounts do not have to be deducted to calculate tentative net capital.

³⁶ Exchange Act rule 18a-1(d)(1) [17 CFR 240.18a-1(d)(1)].

The rules specify the application process for authorization to use a model. Exchange Act rule 18a-1(d) [17 CFR 240.18a-1(d)]. The rules also set forth requirements related to acceptable models. Exchange Act rule 18a-1(e) [17 CFR 240.18a-1(e)].

³⁷ Exchange Act rule 18a-2 [17 CFR 240.18a-2]. For these purposes, the term "tangible net worth" means the major participant's net worth (as determined in accordance with generally accepted accounting principles in the United States), excluding goodwill and other intangible assets.

³⁸ In adopting margin rules, the Commission recognized the importance of providing for adequate liquidity, particularly at times of financial strain:

Obtaining collateral is one of the ways OTC derivatives dealers manage their credit risk exposure to OTC derivatives counterparties. Prior to the financial crisis, in certain circumstances, counterparties were able to enter into OTC derivatives transactions without having to deliver collateral. When "trigger events" occurred during the financial crisis, those counterparties faced significant liquidity strains when they were required to deliver collateral.

See Capital and Margin Adopting Release, 84 FR at 43949.

- What are the prerequisites for netting agreements in connection with calculating margin?
- What is the required frequency for calculating and collecting/delivering margin?
- How much time is allowed to liquidate accounts in the event of margin shortfalls?
- What collateral haircuts are required in connection with the exchange of margin?
- To what extent are third-party custodians permitted to hold counterparty collateral?
- To what extent are there exceptions to the margin requirement?

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

As noted above, the Exchange Act provides in part that applicable capital and margin requirements shall “help ensure the safety and soundness” of security-based swap dealers and major security-based swap participants, and be appropriate for the risks associated with the uncleared security-based swaps they hold.³⁹

Under Commission rules, nonbank security-based swap dealers generally are required to calculate initial margin (or “potential future exposure”) and variation margin (or “current exposure”) as of the close of each business day for each counterparty account.⁴⁰ Absent applicable exceptions, by the close of the first business day following the calculation⁴¹ the security-based swap dealer must do the following:

- Variation margin collection – The security-based swap dealer must collect collateral in an amount equal to the security-based swap dealer’s current exposure to the counterparty.⁴²
- Variation margin delivery – The security-based swap dealer must deliver collateral in an amount equal to the counterparty’s current exposure to the dealer, other than initial margin that the security-based swap dealer collected.⁴³
- Initial margin collection – The security-based swap dealer must collect collateral in an amount equal to the initial margin amount.⁴⁴

³⁹ See note 19, *supra*, and accompanying text (addressing Exchange Act section 15F(e)(3)(A)).

⁴⁰ Exchange Act rule 18a-3(c)(1)(i) [17 CFR 240.18a-3(c)(1)(i)].

The security-based swap dealer must make the calculations more frequently “during periods of extreme volatility and for accounts with concentrated positions.” Exchange Act rule 18a-3(c)(6) [17 CFR 240.18a-3(c)(6)].

⁴¹ This can be completed on the second business day if the counterparty is located in another country and more than four time zones away.

⁴² Exchange Act rule 18a-3(c)(1)(ii)(A)(1) [17 CFR 240.18a-3(c)(1)(ii)(A)(1)].

⁴³ Exchange Act rule 18a-3(c)(1)(ii)(A)(2) [17 CFR 240.18a-3(c)(1)(ii)(A)(2)].

⁴⁴ Exchange Act rule 18a-3(c)(1)(ii)(B) [17 CFR 240.18a-3(c)(1)(ii)(B)].

The rule does not require security-based swap dealers to deliver initial margin, but does not prohibit the practice.

The security-based swap dealer must take prompt steps to liquidate positions in an account that does not meet the margin requirements to the extent necessary to eliminate the margin deficiency.⁴⁵ The dealer may account for netting agreements when calculating collection and delivery amounts under specified circumstances.⁴⁶

The rule sets forth a standardized approach to calculating initial margin, for firms that do not use models to perform the calculation.⁴⁷ Alternatively, firms may apply for authorization to use models (including an industry standard model) to calculate initial margin, subject to conditions addressing, *inter alia*, the associated confidence level, risk factors considered, and the use of empirical correlations.⁴⁸

⁴⁵ Exchange Act rule 18a-3(c)(7) [17 CFR 240.18a-3(c)(7)].

⁴⁶ The use of netting agreements to calculate the collection and delivery amounts is permissible so long as: (i) the netting agreement must be enforceable in each relevant jurisdiction, including in insolvency proceedings; (ii) the gross receivables and gross payables under the netting agreement can be determined at any time; and (iii) for internal risk management purposes, the dealer monitors and controls its exposure to the counterparty on a net basis. Exchange Act rule 18a-3(c)(5) [17 CFR 240.18a-3(c)(5)].

⁴⁷ Under the standardized approach, if the dealer is not also registered as a broker-dealer, it must calculate initial margin using standardized haircuts specified as part of the capital provisions of rule 18a-1. Exchange Act rule 18a-3(d)(1) [17 CFR 240.18a-3(d)(1)]. For credit default swaps, the stand-alone dealer must use the calculation method specified in Exchange Act rule 18a-1(c)(1)(vi)(B)(1) [17 CFR 240.18a-1(c)(1)(vi)(B)(1)]; for other security-based swaps, the standalone dealer must use the calculation method specified in Exchange Act rule 18a-1(c)(1)(vi)(B)(2) [17 CFR 240.18a-1(c)(1)(vi)(B)(2)].

If the security-based swap dealer also is registered as a broker-dealer, it must calculate initial margin using standardized haircuts specified as part of the broker-dealer capital provisions of rule 15c3-1. Exchange Act rule 18a-3(d)(1) [17 CFR 240.18a-3(d)(1)]. For credit default swaps, the security-based swap dealer/broker-dealer must use the calculation method specified in Exchange Act rule 15c-3(c)(1)(vi)(P)(1) [17 CFR 240.15c-3(c)(1)(vi)(P)(1)]; for other security-based swaps, the security-based swap dealer/broker-dealer must use the calculation method specified in Exchange Act rule 15c-3(c)(1)(vi)(P)(2) [17 CFR 240.15c-3(c)(1)(vi)(P)(2)].

⁴⁸ For security-based swaps other than equity security-based swaps, a security-based swap dealer, an acceptable model must use a 99 percent, one-tailed confidence level with price changes equivalent to a ten business-day movement in rates and prices. The model further must use risk factors sufficient to cover all the material price risks inherent in the positions for which the initial margin amount is being calculated, including foreign exchange or interest rate risk, credit risk, equity risk, and commodity risk, as appropriate. Empirical correlations may be recognized by the model within each broad risk category, but not across broad risk categories. See Exchange Act rule 18a-3(d)(2)(i) [17 CFR 240.18a-3(d)(2)(i)].

For equity security-based swaps, a security-based swap dealer that is not registered as a broker-dealer (other than as an OTC derivatives dealer) may apply for authorization to use models to calculate initial margin, subject to the above requirements, provided the counterparty's account does not hold equity security positions other than equity security-based swaps and equity swaps. See Exchange Act rule 18a-3(d)(2)(ii) [17 CFR 240.18a-3(d)(2)(ii)]. A security-based swap

The value of collateral delivered pursuant to the rule is subject to standardized haircuts set forth in the applicable capital rules,⁴⁹ but a security-based swap dealer can elect to apply the standardized haircuts set forth in CFTC rules if the security-based swap dealer applies those deductions consistently with respect to a particular counterparty.⁵⁰ Margin collateral must have a ready market and be readily transferrable.⁵¹ The rule also sets forth possession and control requirements for collateral.⁵²

The margin rule further requires that security-based swap dealers must monitor the risk of each account and establish, maintain and document procedures and guidelines for monitoring the risk of accounts as part of their required risk management and control systems.⁵³

Major security-based swap participants generally are required to post and collect variation margin, but are not required to collect or deliver initial margin.⁵⁴

The rule sets forth a number of targeted exceptions to the margin collection and delivery requirements, addressing the following: commercial end user accounts⁵⁵; the Bank for

dealer that is also registered as a broker-dealer (other than an OTC derivatives dealer) must use the standardized haircuts to compute initial margin for non-cleared equity security-based swaps.

⁴⁹ Exchange Act rule 18a-3(c)(3)(i) [17 CFR 240.18a-3(c)(3)(i)].

⁵⁰ Exchange Act rule 18a-3(c)(3)(ii) [17 CFR 240.18a-3(c)(3)(ii)] (cross-referencing 17 CFR 23.156).

⁵¹ Acceptable collateral consists of cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold. The collateral cannot consist of securities and/or money market instruments issued by the counterparty, or by a party related to the dealer, or the counterparty. The collateral must be subject to an agreement that is legally enforceable by the dealer against counterparty and any other parties to the agreement. Exchange Act rule 18a-3(c)(4)(i) [17 CFR 240.18a-3(c)(4)(i)].

⁵² In particular, collateral must be either: (A) subject to the dealer's physical possession or control, and able to be liquidated promptly by the dealer without intervention by any other party; or (B) carried by an independent third-party custodian that is a bank or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies. Exchange Act rule 18a-3(c)(4)(ii) [17 CFR 240.18a-3(c)(4)(ii)]. There is a corresponding exception from the initial margin collection requirement for dealers when a counterparty delivers margin to an independent third-party custodian. *See* Exchange Act rule 18a-3(c)(1)(iii)(C) [17 CFR 240.18a-3(c)(1)(iii)(C)].

⁵³ The rule specifies minimum requirements for associated policies and procedures including, *inter alia*, requirements related to the review or monitoring of financial information, counterparty credit limits and credit risk exposure, the use of stress tests, determinations regarding the need to collect collateral, and the maintenance of sufficient equity in each counterparty account. Exchange Act rule 18a-3(e) [17 CFR 240.18a-3(e)].

⁵⁴ Exchange Act rule 18a-3(c)(2) [17 CFR 240.18a-3(c)(2)].

⁵⁵ In particular, dealers need not collect initial margin, and need not collect or deliver variation margin. Exchange Act rule 18a-3(c)(1)(iii)(A) [17 CFR 240.18a-3(c)(1)(iii)(A)]. This exception

International Settlements, the European Stability Mechanism, and certain other multilateral development banks⁵⁶; financial market intermediary accounts⁵⁷; affiliate accounts⁵⁸; accounts of sovereigns with minimal credit risk⁵⁹; legacy accounts⁶⁰; initial margin below a \$50 million threshold⁶¹; and minimum transfer amounts.⁶²

D. Internal risk management requirements

The risk control requirements in part address the obligation of registered entities to follow policies and procedures reasonably designed to assist them in managing the risks associated with their business activities.

Your jurisdiction's requirements

Relevant information for the discussion regarding your jurisdiction's requirements related to internal risk management control systems may include (along with other relevant factors):

- To what extent are firms required to implement internal risk management controls?
- What types of risks are those internal controls required to address?

The Staff suggests that you also address generally the comparability of your jurisdiction's requirements and analogous requirements under the Exchange Act, including any general

also applies to major participants. *See* Exchange Act rule 18a-3(c)(2)(iii)(A) [17 CFR 240.18a-3(c)(2)(iii)(A)].

⁵⁶ In particular, dealers need not collect initial margin, and need not collect or deliver variation margin. Exchange Act rule 18a-3(c)(1)(iii)(E) [17 CFR 240.18a-3(c)(1)(iii)(E)]. This exception also applies to major participants. *See* Exchange Act rule 18a-3(c)(2)(iii)(C) [17 CFR 240.18a-3(c)(2)(iii)(C)].

⁵⁷ In particular, dealers need not collect initial margin, but still need to collect and deliver variation margin. Exchange Act rule 18a-3(c)(1)(iii)(B) [17 CFR 240.18a-3(c)(1)(iii)(B)].

⁵⁸ In particular, dealers need not collect initial margin, but still need to collect and deliver variation margin. Exchange Act rule 18a-3(c)(1)(iii)(G) [17 CFR 240.18a-3(c)(1)(iii)(G)].

⁵⁹ In particular, dealers need not collect initial margin, but still need to collect and deliver variation margin. Exchange Act rule 18a-3(c)(1)(iii)(F) [17 CFR 240.18a-3(c)(1)(iii)(F)].

⁶⁰ In particular, dealers need not collect initial margin, and need not collect or deliver variation margin. Exchange Act rule 18a-3(c)(1)(iii)(D) [17 CFR 240.18a-3(c)(1)(iii)(D)]. This exception also applies to major participants. *See* Exchange Act rule 18a-3(c)(2)(iii)(B) [17 CFR 240.18a-3(c)(2)(iii)(B)].

⁶¹ This provision does not alter the obligation to collect and deliver variation margin. Exchange Act rule 18a-3(c)(1)(iii)(H) [17 CFR 240.18a-3(c)(1)(iii)(H)].

⁶² In particular, dealers need not collect initial margin, and need not collect or deliver variation margin until the total amount of collateral that needs to be collected with respect to the counterparty is greater than \$500,000. Exchange Act rule 18a-3(c)(1)(iii)(I) [17 CFR 240.18a-3(c)(1)(iii)(I)]. This exception also applies to major participants. *See* Exchange Act rule 18a-3(c)(2)(iii)(D) [17 CFR 240.18a-3(c)(2)(iii)(D)].

differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

Exchange Act section 15F(j)(2) [15 U.S.C. 78o-10(j)(2)] requires that security-based swap dealers and major security-based swap participants “establish robust and professional risk management systems adequate for managing [their] day-to-day business.”

Commission rules generally require that dealers and major participants, as part of their supervisory systems, establish, maintain and enforce written policies and procedures addressing that obligation (as well as various other obligations).⁶³

More specifically, the capital rule for nonbank dealers and major participants imposes a requirement that those firms comply with a separate rule related to internal risk management control systems.⁶⁴ That latter rule requires firms to establish, document, and maintain a system of internal risk management controls to assist them in managing the risks associated with their business activities, including market, credit, leverage, liquidity, legal, and operational risks.

E. Trade acknowledgment and verification requirements

The risk control requirements in part address trade acknowledgment and verification rules that are intended to help avoid legal and operations risks by providing for definitive written records of transactions and procedures to avoid disagreements regarding the meaning of transaction terms.

Your jurisdiction’s requirements

Relevant information for the discussion regarding your jurisdiction’s trade acknowledgement and verification, confirmation, or similar requirements may include (along with other relevant factors):

- To what extent are transactions subject to trade acknowledgment, confirmation, or similar requirements that provide for the creation of definitive written records of the transaction?
- To what extent are transactions further subject to verification or similar requirements intended to identify disagreements regarding transaction terms?
- What requirements govern the persons responsible for providing trade acknowledgments, confirmations or equivalent records? What requirements govern their contents, delivery and timing?

⁶³ See Exchange Act rule 15Fh-3(h)(2)(iii)(I) [17 CFR 140.15Fh-3(h)(2)(iii)(I)].

⁶⁴ Exchange Act rule 18a-1(f) [17 CFR 240.18a-1(f)] (for dealers); Exchange Act rule 18a-2(c) [17 CFR 240.18a-2(c)] (for major participants). In particular, the firm must comply with Exchange Act rule 15c3-4 [17 CFR 240.15c3-4] as if the firm were an OTC derivatives dealer, with the exclusion of select provisions. Major participants must comply with rule 15c3-4 with respect to their swap and security-based swap activities, and security-based swap dealers must comply with rule 15c3-4 with respect to all of their business activities.

- What requirements govern the substance, policies and procedures, and timing associated with trade verifications?
- To what extent are those requirements subject to exceptions with regard to particular types of transactions?

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

The Commission’s trade acknowledgment rule applies to any transaction in which a security-based swap dealer or major security based swap participant “purchases from or sells to any counterparty a security-based swap.”⁶⁵ The required trade acknowledgment comprises a written or electronic record of a security-based swap transaction sent by one counterparty to the other,⁶⁶ that discloses all the terms of the transaction.⁶⁷ The rule helps to ensure that an acknowledgment is provided for each transaction by prescribing the party that is responsible for providing trade acknowledgments.⁶⁸ The rule further addresses means of delivery⁶⁹ and required timing.⁷⁰

⁶⁵ Exchange Act rule 15Fi-2(a) [17 CFR 240.15Fi-2(a)]. This rule was adopted pursuant to Exchange Act section 15F(i) [15 U.S.C. 78o-10(i)], which directs the Commission to adopt rules governing documentation standards, including confirmations, applicable to dealers and major participants.

⁶⁶ Exchange Act rule 15Fi-1(h) [17 CFR 240.15Fi-1(h)].

⁶⁷ Exchange Act rule 15Fi-2(c) [17 CFR 240.15Fi-2(c)].

⁶⁸ For transactions between a security-based swap dealer and a major security-based swap participant, the security-based swap dealer will provide the trade acknowledgment. For transactions in which only one counterparty is a security-based swap dealer or major security-based swap participant, the dealer or major participant will provide the trade acknowledgment. For all other transactions in which a security-based swap dealer or major security based swap participant purchases or sells a security-based swap, the counterparties will agree as to who provides the trade acknowledgment. Exchange Act rule 15Fi-2(a) [17 CFR 240.15Fi-2(a)].

⁶⁹ Trade acknowledgments must be provided through electronic means that provide reasonable assurance of delivery and a record of transmittal. Exchange Act rule 15Fi-2(c) [17 CFR 240.15Fi-2(c)].

⁷⁰ Trade acknowledgments “must be provided promptly, but in any event by the end of the first business day following the day of execution.” Exchange Act rule 15Fi-2(b) [17 CFR 240.15Fi-2(b)].

For those purposes: the term “business day” means any day other than a Saturday, Sunday or legal holiday; the term “execution” means the point at which the counterparties become irrevocably bound to a transaction under applicable law; and the term “day of execution” means the calendar day of the counterparty to the security-based swap transaction that ends the latest, with special accommodations for late-afternoon and non-business day transactions. *See* Exchange Act rules 15Fi-1(a), (d) and (e) [17 C.F.R. 240.15Fi-1(a), (d) and (e)].

The trade verification requirement applies to security-based swap transactions for which a security-based swap dealer or major participant has received a trade acknowledgment.⁷¹ “Trade verification” means “the process by which a trade acknowledgment has been manually, electronically, or by some other legally equivalent means, signed by the receiving counterparty.”⁷² A dealer or major participant must verify the accuracy of, or dispute with the counterparty, the terms of the trade acknowledgment.⁷³ The rule also addresses required policies and procedures,⁷⁴ and timing.⁷⁵

The trade acknowledgment and verification requirements are subject to exceptions regarding transactions with a clearing agency as counterparty,⁷⁶ transactions on execution facilities,⁷⁷

⁷¹ Exchange Act rule 15Fi-2(d)(2) [17 CFR 240.15Fi-2(d)(2)]. The trade verification requirement accordingly applies to a dealer or major participant that has received a trade acknowledgment (subject to the exceptions addressed below). Exchange Act rule 15Fi-2(d)(2) [17 CFR 240.15Fi-2(d)(2)].

⁷² Exchange Act rule 15Fi-1(i) [17 CFR 240.15Fi-1(i)].

⁷³ Exchange Act rule 15Fi-2(d)(2) [17 CFR 240.15Fi-2(d)(2)].

⁷⁴ Dealers and major participants are required to “establish, maintain, and enforce written policies and procedures that are reasonably designed to obtain prompt verification of the terms of a trade acknowledgment.” Exchange Act rule 15Fi-2(d)(1) [17 CFR 240.15Fi-2(d)(1)]. Those policies and procedures apply regardless of whether the counterparty also is subject to the trade acknowledgment requirement.

The Commission has clarified that the policies and procedures may rely on a counterparty’s “negative affirmation” to the terms of a trade acknowledgment. *See* Trade Acknowledgment and Verification Adopting Release, 81 FR at 39820 (stating that the Commission generally would consider negative affirmation policies and procedures reasonable if they require the counterparty to agree to be bound by negative affirmation before or at the time of execution, and provide adequate time after the counterparty receives the trade acknowledgment to dispute its terms or otherwise respond, and adding that the policies and procedures generally should require the entity to document its counterparty’s agreement to rely on negative affirmation).

⁷⁵ Dealers and major security-based swap participants must “promptly” verify or dispute the terms of trade acknowledgments they receive. Exchange Act rule 15Fi-2(d)(2) [17 CFR 240.15Fi-2(d)(2)].

⁷⁶ An exception applies to any “clearing transaction,” which is defined as a security-based swap “that has a clearing agency as a direct counterparty.” Exchange Act rules 15Fi-1(b), 15Fi-1(c), 15Fi-2(e) [17 CFR 240.15Fi-1(b), 240.15Fi-1(c), 240.15Fi-2(e)].

⁷⁷ An exception applies to transactions executed on a security-based swap execution facility or national securities exchange, provided that the facility’s rules, procedures or processes provide for the acknowledgment and verification of all terms of the transaction “no later than” the time otherwise required by the rule. Exchange Act rule 15Fi-2(f)(1) [17 CFR 240.15Fi-2(f)(1)].

transactions accepted for clearing,⁷⁸ and additional provisions for transactions that have not been acknowledged, verified or accepted for clearing.⁷⁹

F. Risk mitigation requirements

The risk control requirements in part address rules to mitigate market, credit, operational and legal risks by requiring that registered entities take steps to identify and resolve discrepancies in transaction terms and valuations, reduce offsetting or redundant security-based swaps, and document their trading relationships.

Your jurisdiction's requirements

Relevant information for the discussion regarding your jurisdiction's requirements related to risk mitigation may include (along with other relevant factors):

- To what extent are parties to transactions required to reconcile transaction terms and valuation discrepancies?
- To what extent are parties to transactions required to engage in bilateral offset, bilateral or multilateral compression, or similar exercises to reduce offsetting or redundant instruments?
- To what extent are parties to transactions required to document the terms of their trading relationships?

The Staff suggests that you also address generally the comparability of your jurisdiction's requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

The Commission's risk mitigation rules encompass requirements addressing portfolio reconciliation, portfolio compression and trading relationship documentation.⁸⁰

⁷⁸ An exception applies to transactions that are submitted for clearing to a clearing agency, provided: (i) the transaction is submitted "as soon as technologically practicable, but in any event no later than the time established for providing a trade acknowledgment" under the rule; and (ii) the clearing agency's rules, procedures or processes provide for acknowledgment and verification of all terms of the transaction "prior to or at the same time" the transaction is accepted for clearing. Exchange Act rule 15Fi-2(f)(2) [17 CFR 240.15Fi-2(f)(2)].

⁷⁹ If a dealer or major swap participant receives notice that a transaction has not been acknowledged and verified pursuant to the rules, procedures or processes of an execution facility or exchange, or accepted for clearing by a clearing agency (per the above exceptions), the firm must comply with the applicable trade acknowledgment and verification requirements "as if" the transaction were executed at the time it receives the notice. Exchange Act rule 15Fi-2(f)(3) [17 CFR 240.15Fi-2(f)(3)].

⁸⁰ As with the trade acknowledgment and verification rule, the Commission adopted the risk mitigation requirements pursuant to Exchange Act section 15F(i). *See* note 65, *supra*.

The portfolio reconciliation rule requires that security-based swap dealers and major security-based swap participants take certain actions to engage in portfolio reconciliation with their counterparties.⁸¹ Dealers and major participants further must resolve discrepancies in the material terms⁸² or valuation of security-based swaps,⁸³ and must promptly notify the Commission and any applicable prudential regulation regarding security-based swap valuation disputes in excess of \$20 million (or its equivalent), at either the transaction or portfolio level, if

⁸¹ Paragraph (a) to rule 15Fi-3 [17 CFR 240.15Fi-3] addresses the portfolio reconciliation requirement for portfolios of security-based swap transactions with counterparties that also are security-based swap dealers or major security-based swap participants. That paragraph expressly requires the two counterparties to engage in portfolio reconciliation in the manner specified in the rule. Paragraph (b) to that rule requires dealers and major participants to establish, maintain, and follow written policies and procedures reasonably designed to ensure that it engages in portfolio reconciliation for transactions with all other counterparties in the manner set forth in the rule. Both paragraphs address the potential use of third-party service providers to perform the reconciliations, and require the security-based swap dealer or major security-based swap to agree in writing on the terms of the portfolio reconciliation with its counterparties.

For counterparties that also are dealers or major participants, the rule requires that the portfolio reconciliation be performed no less frequently than once per business day for portfolios that include 500 or more security-based swaps, once each week for portfolios that include more than 50 (but fewer than 500) security-based swaps, and once each calendar quarter for portfolios that include no more than 50 security-based swaps at any time during the quarter. Exchange Act rule 15Fi-3(a)(3) [17 CFR 240.15Fi-3(a)(3)].

For other counterparties, the rule requires that the portfolio reconciliation be performed no less frequently than once each calendar quarter for portfolios that include no more than 100 security-based swaps at any time during the quarter, and once annually for portfolios that include no more than 100 security-based swaps at any time during the calendar year. Exchange Act rule 15Fi-3(b)(3) [17 CFR 240.15Fi-3(b)(3)].

⁸² In this context, a “material term” includes each term that is required to be reported to a security-based swap data repository or the Commission pursuant to Regulation SBSR rule 901 [17 CFR 242.901]. That definition excludes any term that is not relevant to the ongoing rights and obligations of the parties and the valuation of the security-based swap. *See* Exchange Act rule 15Fi-1(i) [17 CFR 240.15Fi-1(i)].

⁸³ Where the dealer or major participant’s counterparty also is a security-based swap dealer or major security-based swap participant, the rule requires that discrepancies in material terms be resolved immediately. Exchange Act rule 15Fi-3(a)(4) [17 CFR 240.15Fi-3(a)(4)]. For those counterparties, the rule further requires that the dealer or major participant establish, maintain and follow written policies and procedures reasonably designed to resolve valuation discrepancies of ten percent or more as soon as possible but in any event within five business days (provided that the dealer or major participant has procedures to identify how it will comply with applicable variation margin requirements pending resolution of the discrepancy). Exchange Act rule 15Fi-3(a)(5) [17 CFR 240.15Fi-3(a)(5)].

For other counterparties, the rule more generally requires that the dealer or major participant establish, maintain and follow written procedures reasonably designed to resolve discrepancies in valuation (of ten percent or less) or in the material terms of security-based swaps in a timely fashion. Exchange Act rule 15Fi-3(b)(4) [17 CFR 240.15Fi-3(b)(4)].

not resolved within a specified period of time.⁸⁴ The portfolio reconciliation requirement does not apply to cleared security-based swaps.⁸⁵

The Commission's portfolio compression rule requires dealers and major participants to establish, maintain and follow written policies and procedures addressing bilateral offset, bilateral compression and multilateral compression.⁸⁶ The portfolio compression rule does not apply to cleared security-based swaps.⁸⁷

The Commission's trading relationship documentation rule requires that security-based swap dealers and major security-based swap participants establish, maintain and follow policies and procedures reasonably designed to ensure that they execute written security-based swap trading relationship documentation with each of their counterparties prior to, or contemporaneously with, executing a security-based swap. The rule further provides that the trading relationship documentation address, in part: payment obligations, netting, termination events, termination obligations, transfer of rights and obligations, governing law, valuation, dispute resolution, trade acknowledgments and verifications, and credit support arrangements.⁸⁸ The rule also requires dealers and major participants to have an independent audit of their documentation policies and

⁸⁴ Those disputes must be reported within three business days if the dispute is with a counterparty that also is a security-based swap dealer or major security-based swap participant, or within five business days for disputes with other counterparties. Exchange Act rule 15Fi-3(c)(1) [17 CFR 240.15Fi-3(c)(1)]. Dealers and major participants must provide amended notices if the amount of any valuation dispute that was the subject of a previous notice increases or decreases by more than \$20 million (or its equivalent) at the transaction or portfolio level. Exchange Act rule 15Fi-3(c)(2) [17 CFR 240.15Fi-3(c)(2)].

⁸⁵ Exchange Act rule 15Fi-3(d) [17 CFR 240.15Fi-3(d)].

⁸⁶ In particular, for counterparties that also are security-based swap dealers or major security-based swap participants, the rule addresses bilateral offset, bilateral compression and multilateral compression. Exchange Act rule 15Fi-4(a) [17 CFR 240.15Fi-4(a)].

For other counterparties, the rule addresses bilateral or multilateral compression. Exchange Act rule 15Fi-4(b) [17 CFR 240.15Fi-4(b)].

⁸⁷ Exchange Act rule 15Fi-4(c) [17 CFR 240.15Fi-4(c)].

⁸⁸ Exchange Act rule 15Fi-5(a)(2), (b)(1)-(3) [17 CFR 240.15Fi-5(a)(2), (b)(1)-(3)].

In addition, in certain instances – where both counterparties are dealers, major participants or financial counterparties, or upon request by a counterparty – the trading relationship documentation must include written documentation regarding the process for determining the value of security-based swaps for purposes of complying with margin and risk management requirements. Exchange Act rule 15Fi-5(b)(4) [17 CFR 240.15Fi-5(b)(4)]. For those purposes, the term “financial counterparty” includes swap dealers, major swap participants, certain commodity pools, private funds and employee benefit plans, and persons predominately engaged in activities that are in the business of banking or that are financial in nature. Exchange Act rule 15Fi-1(g) [17 CFR 240.15Fi-1(g)].

The required trading relationship documentation also must address information regarding the status of the dealer or major participant, or its counterparty, as an insured financial institution or financial company, as well as information regarding security-based swaps that have been accepted for clearing. Exchange Act rules 15Fi-5(b)(5)-(6) [17 CFR 240.15Fi-5(b)(5)-(6)].

procedures. The trading relationship documentation rule does not apply to pre-existing security-based swaps, cleared security-based swaps, or to certain security-based swaps executed anonymously on a national securities exchange or security-based swap execution facility.⁸⁹

⁸⁹ Exchange Act rule 15Fi-5(a)(1) [17 CFR 240.15Fi-5(a)(1)].

II. Recordkeeping and reporting requirements

The recordkeeping and reporting requirements provide for records, reports and notices to facilitate the Commission’s oversight of registrants, by enabling Commission access to key information in connection with the Commission’s obligation to protect the integrity of the security-based swap market and to protect market participants.⁹⁰ These also include quarterly securities count practices intended to help guard against deficiencies in firms’ internal controls.⁹¹ These entity-level requirements generally apply to the entirety of a firm’s business, regardless of the location of the business or counterparty.

These consist of the following requirements:⁹²

- *Record creation* – as provided by Exchange Act rule 18a-5 [17 CFR 240.18a-5].
- *Record maintenance* – as provided by Exchange Act rule 18a-6 [17 CFR 240.18a-6].
- *Reports* – as provided by Exchange Act rule 18a-7 [17 CFR 240.18a-7].
- *Notifications* – as provided by Exchange Act rule 18a-8 [17 CFR 240.18a-8].
- *Quarterly security counts* – as provided by Exchange Act rule 18a-9 [17 CFR 240.18a-9].⁹³

As discussed above, those requirements (as well as certain capital, margin and segregation requirements addressed above) are subject to an alternative compliance mechanism based on compliance with certain requirements adopted pursuant to the Commodity Exchange Act.⁹⁴

⁹⁰ In proposing those requirements, the Commission generally addressed how the requirements were designed to provide transparency into the business activities of dealers and major participants, and assist the Commission in reviewing and monitoring compliance with proposed financial responsibility requirements. *See* Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25194, 25197 (May 2, 2014). The Commission further explained that the proposed notification and requirements had its genesis in lessons learned from the securities industry “paperwork crisis” of 1967-70. “The Commission would use the notifications to respond, when necessary, to financial or operational problems at a particular [firm] by, for example, heightening its supervision of the firm.” *See id.* at 25247.

⁹¹ As part of that proposal, the Commission also noted that the “paperwork crisis” of 1967-70 led to required quarterly securities counts as part of efforts to eliminate deficiencies in internal controls and procedures for safeguarding securities. *See id.* at 25252-53.

⁹² For further information regarding these requirements, *see generally* Exchange Act Release No. 87005 (Sep. 19, 2019), 84 FR 68550 (Dec. 16, 2019) (“Books and Records Adopting Release”).

⁹³ These requirements apply to security-based swap dealers and major security-based swap participants that are not also registered with the Commission as broker-dealers. Security-based swap dealers that also are registered as broker-dealers instead are subject to the Commission’s broker-dealer recordkeeping and reporting requirements. *See, e.g.*, Exchange Act rules 17a-3, 17a-4, 17a-5 and 17a-11. Substituted compliance is not available in connection with broker-dealer requirements.

⁹⁴ *See* note 14, *supra*, and accompanying text.

A. Criteria for assessing comparability

Consistent with the holistic approach toward assessing the comparability of regulatory outcomes in connection with substituted compliance, the comparability assessment associated with these requirements may focus on the comparability of individual requirements or, alternatively, may focus on whether the analogous requirements of a foreign jurisdiction – taken as a whole – produce similar outcomes as Exchange Act requirements with regard to the overall goal of supporting the Commission’s oversight of registrants. This latter approach does not require that the foreign jurisdiction have analogues to every requirement under Commission rules as long as the overall requirements of a foreign jurisdiction provide similar regulatory outcomes.

Exchange Act rule 3a71-6(d)(6) [17 CFR 240.3a71-6(d)(6)] further provides in relevant part that in making substituted compliance determinations the Commission intends to consider whether “the foreign financial regulatory system’s required records and reports, the timeframes for recording or reporting information, the accounting standards governing the records and reports, and the required format of the records and reports” are comparable to applicable Exchange Act provisions and underlying rules, as well as whether the foreign regulatory system “would permit the Commission to examine and inspect regulated firms’ compliance with the applicable securities laws.”

B. Records required to be made

The recordkeeping and reporting requirements in part address records that firms must create – regarding the firms’ financial status, positions, activities, and compliance with applicable requirements – to promote effective Commission oversight, as well as securities counts intended to help guard against deficiencies in firms’ internal controls.

Your jurisdiction’s requirements

Relevant information for the discussion regarding your jurisdiction’s requirements for records that firms are required to make may include (along with other relevant factors):

- What records are firms required to make with regard to their transactions and other activities?
- What records are firms required to make with regard to their positions and other potential financial liabilities?
- What records are firms required to make with regard to their personnel, including records regarding the background of individuals?
- What records are firms required to make regarding the control of customer funds and securities?
- What records are firms required to make regarding business conduct practices?
- To what extent are firms required to make periodic securities counts or similar records to help ensure the proper care and protection of assets?
- Are there potential restrictions or prohibitions on the ability of firms to receive, create or maintain certain of those types of information, such as information regarding counterparties and associated persons? Are there potentially any restrictions on the ability of the Commission to access particular types of records?

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements⁹⁵

The Exchange Act provides that registered security-based swap dealers and major security-based swap participants must keep applicable books and records in the form and manner, and for the period, prescribed by the Commission, and keep those books and records open to inspection and examination by any representative of the Commission.⁹⁶ The Exchange Act further provides that those firms must maintain daily trading records of security-based swaps, and related records and recorded communications, for the period prescribed by the Commission.⁹⁷

Under Commission rules, security-based swap dealers and major security-based swap participants are required to make and keep current the following types of records: trade blotters,⁹⁸ ledgers,⁹⁹ ledger accounts,¹⁰⁰ securities records or ledgers,¹⁰¹ memoranda of brokerage

⁹⁵ Certain of the requirements discussed below vary depending on whether the security-based swap dealer or major security-based swap participant at issue has a prudential regulator. The term “prudential regulator” is defined in Commodity Exchange Act section 1a(39) [7 U.S.C. 1a(39)] (which is incorporated by reference by Exchange Act section 3(a)(74) [15 U.S.C. 78c(a)(74)]).

⁹⁶ Exchange Act section 15F(f)(1)(B), (C) [15 U.S.C. 78o-10(f)(1)(B), (C)]. For firms that have a prudential regulator, the recordkeeping requirements specifically apply to the firm’s business as a security-based swap dealer or major security-based swap participant.

⁹⁷ Exchange Act section 15F(g) [15 U.S.C. 78o-10(g)]. This provision also addresses the need to maintain the records for each counterparty in an identifiable manner and form, and that firms maintain a complete audit trail for trade reconstructions.

⁹⁸ Exchange Act rule 18a-5(a)(1) [17 CFR 240.18a-5(a)(1)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-5(b)(1) [17 CFR 240.18a-5(b)(1)] (for dealers and major participants with a prudential regulator). These provisions require blotters or other records of original entry containing an itemized daily record of purchases and sales of securities, receipts and deliveries of securities, and receipts and disbursements of cash and other debits and credits, as well as additional information such as account-related information and information regarding security-based swaps (*e.g.*, type, reference security, unique transaction identifier, and counterparty identifier).

⁹⁹ Exchange Act rule 18a-5(a)(2) [17 CFR 240.18a-5(a)(2)]. This provision requires ledgers or other records reflecting assets and liabilities, income and expense and capital accounts. This provision applies only to dealers and major participants without a prudential regulator.

¹⁰⁰ Exchange Act rule 18a-5(a)(3) [17 CFR 240.18a-5(a)(3)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-5(b)(2) [17 CFR 240.18a-5(b)(2)] (for dealers and major participants with a prudential regulator). These provisions require ledger accounts or other records to itemize separately, as to each account, information such as purchases and sales, receipts and deliveries of securities and commodities, and other debits and credits, along with additional information regarding security-based swaps.

¹⁰¹ Exchange Act rule 18a-5(a)(4) [17 CFR 240.18a-5(a)(4)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-5(b)(3) [17 CFR 240.18a-5(b)(3)] (for dealers and major participants with a prudential regulator). For securities other than security-

orders or instructions,¹⁰² memoranda of security-based swap transactions for the firm account,¹⁰³ confirmations or trade acknowledgments/verifications,¹⁰⁴ security-based swap counterparty information,¹⁰⁵ records of options positions,¹⁰⁶ trial balances,¹⁰⁷ information regarding associated

based swaps, this includes information regarding long or short positions, location-related information and account-related information. For security-based swaps, this includes information such as the reference security, transaction and counterparty identifiers, whether the position is bought or sold, and clearing-related information. For dealers and major participants with a prudential regulator, the requirement extends only to security-based swaps and securities positions related to the firm's business as a security-based swap dealer or major security-based swap participant.

¹⁰² Exchange Act rule 18a-5(b)(4) [17 CFR 240.18a-5(b)(4)]. This provision requires memoranda of brokerage orders and related instructions associated with the purchase or sale of security-based swaps, along with additional categories of information (*e.g.*, information regarding terms and conditions, and regarding responsible associated persons), and designation of orders entered pursuant to the exercise of discretionary authority. This requirement applies only to firms with a prudential regulator, because firms without a prudential regulator cannot engage in the business of effecting brokerage transactions without also being registered as a broker-dealer or a bank. *See* Books and Records Adopting Release, 84 FR at 68555-56.

¹⁰³ Exchange Act rule 18a-5(a)(5) [17 CFR 240.18a-5(a)(5)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-5(b)(5) [17 CFR 240.18a-5(b)(5)] (for dealers and major participants with a prudential regulator). These provisions require memoranda of each purchase or sale of a security-based swap for the firm's account, showing price, other information related to the security-based swap, and transaction and counterparty identifiers, and designating orders that are entered pursuant to the exercise of discretionary authority.

¹⁰⁴ Exchange Act rule 18a-5(a)(6) [17 CFR 240.18a-5(a)(6)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-5(b)(6) [17 CFR 240.18a-5(b)(6)] (for dealers and major participants with a prudential regulator). These provisions require copies of purchase and sale confirmations for securities other than security-based swaps, and copies of trade acknowledgments and verifications for security-based swaps.

¹⁰⁵ Exchange Act rule 18a-5(a)(7) [17 CFR 240.18a-5(a)(7)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-5(b)(7) [17 CFR 240.18a-5(b)(7)] (for dealers and major participants with a prudential regulator). These provisions require, for each security-based swap account, a record of the counterparty's unique identification code, name and address, and of the authorization for each person with authority to transact on behalf of the counterparty.

¹⁰⁶ Exchange Act rule 18a-5(a)(8) [17 CFR 240.18a-5(a)(8)]. This provision requires a record of all options in which the firm has a direct or indirect interest or that the firm has granted or guaranteed, containing at least the security identification and the number of units involved. This requirement applies only to dealers and major participants without a prudential regulator.

¹⁰⁷ Exchange Act rule 18a-5(a)(9) [17 CFR 240.18a-5(a)(9)]. This provision requires a record of the proof of money balances of all ledger accounts in the form of trial balances and certain records relating to the computation of aggregate indebtedness and net capital under the net capital rule. This requirement applies only to dealers and major participants without a prudential regulator.

persons,¹⁰⁸ current exposure calculation,¹⁰⁹ segregation-related information,¹¹⁰ non-verified security-based swaps,¹¹¹ compliance with certain security-based swap business conduct standards,¹¹² and compliance with risk mitigation standards.¹¹³

¹⁰⁸ Exchange Act rule 18a-5(a)(10) [17 CFR 240.18a-5(a)(10)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-5(b)(8) [17 CFR 240.18a-5(b)(8)] (for dealers and major participants with a prudential regulator). These provisions require a questionnaire or employment application for each associated person who effects or is involved in effecting security-based swaps on the firm's behalf, containing identifying and background information (*e.g.*, information regarding disciplinary actions, and arrests and indictments). The firm must also make a record that lists the offices associated with each associated person of the firm. The Commission has clarified that those recordkeeping requirements apply only to natural persons, and not to legal entities that may be associated persons. *See* Books and Records Adopting Release, 84 FR at 68558.

Because the Commission recognizes that there may be situations in which firms are prohibited by applicable non-U.S. law from receiving, creating, or maintaining records with respect to certain of this information that needs to be recorded pursuant to the questionnaire requirement, the Commission has proposed additional provisions in Rule 18a-5 to address those situations. *See* Exchange Act Release No. 85823 (May 10, 2019), 84 FR 24206, 24242-44, 24294 (May 24, 2019).

¹⁰⁹ Exchange Act rule 18a-5(a)(12) [17 CFR 240.18a-5(a)(12)]. This provision requires a record of daily calculations of current exposure and the initial margin amount for each account, consistent with the relevant capital rule. This provision applies only to dealers and major participants without a prudential regulator.

¹¹⁰ Exchange Act rule 18a-5(a)(13), (14) [17 CFR 240.18a-5(a)(13), (14)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-5(b)(9), (10) [17 CFR 240.18a-5(b)(9), (10)] (for dealers and major participants with a prudential regulator). These provisions require records of compliance with the possession or control requirement under the applicable segregation rule, and of the reserve computation required under the segregation rule.

¹¹¹ Exchange Act rule 18a-5(a)(15) [17 CFR 240.18a-5(a)(15)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-5(b)(11) [17 CFR 240.18a-5(b)(11)] (for dealers and major participants with a prudential regulator). These provisions require records of each security-based swap that has not been verified, including transaction and counterparty identifiers.

¹¹² Exchange Act rule 18a-5(a)(16), (17) [17 CFR 240.18a-5(a)(16), (17)] (for firms without a prudential regulator; (a)(16) applies only to dealers); Exchange Act rule 18a-5(b)(12), (13) [17 CFR 240.18a-5(b)(12), (13)] (for firms with a prudential regulator; (b)(12) applies only to dealers).

These provisions require records regarding compliance with business conduct standards that address, among other respects: verification related to counterparty status; certain disclosures related to the daily mark and its calculation; disclosures regarding material incentives, conflicts of interest, material risks, and characteristics of the security-based swap, and certain clearing rights; certain "know your counterparty" and suitability obligations; supervisory requirements, including written policies and procedures; certain requirements regarding interactions with special entities; provisions intended to prevent dealers from engaging in certain "pay to play" activities; and certain minimum requirements relating to chief compliance officers.

Firms may comply with the above requirements related to trade blotters, ledger accounts and securities records/ledgers via compliance with certain CFTC requirements, so long as, *inter alia*, the firm is registered with the CFTC as a swap dealer or major swap participant, preserves all of the data elements necessary to create the records required by the Commission's rule, and provides the required records to Commission staff upon request.¹¹⁴

Commission rules further require security-based swap dealers without a prudential regulator to perform a securities count each quarter.¹¹⁵

C. Records required to be preserved

The recordkeeping and reporting regulatory requirements in part address the preservation of records – regarding firms' financial status, positions, activities and compliance with applicable requirements – to promote effective Commission oversight.

Your jurisdiction's requirements

Relevant information for the discussion regarding your jurisdiction's requirements for records that firms are required to preserve may include (along with other relevant factors):

- What are the general provisions regarding the preservation period and accessibility?
- To what extent are firms required to preserve the types of records that are the subject of the Exchange Act record preservation requirement (*e.g.*, bank records, bills, communications, account documents, written agreements and risk management records)?
- To what extent are firms required to preserve specific information regarding associated persons?
- What requirements address firms' use of electronic storage systems and third party contractors in connection with record preservation?

¹¹³ Exchange Act rule 18a-5(a)(18) (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-5(b)(14) (for dealers and major participants with a prudential regulator). These provisions require records regarding security-based swap portfolio reconciliations, notices of valuation disputes, and portfolio compression exercises.

¹¹⁴ Exchange Act rule 18a-5(c) [17 CFR 240.18a-5(c)].

¹¹⁵ Exchange Act rule 18a-9 [17 CFR 240.18a-9]. The firm may perform this count as of a date certain or on a cyclical basis subject covering the entire list of securities, and the count must be made or supervised by persons whose regular duties do not require them to have direct responsibility for the proper care and protection of the securities or the making or preservation of the subject records.

In adopting this requirement the Commission acknowledged that security-based swaps are not held in depositories or at other types of custodians. The Commission further stated that to meet this requirement, a firm generally will need to account for or verify its open security-based swap transactions, and that the method to do this could involve steps to confirm open transactions reflected in the firm's books and records with securities clearing agencies or counterparties. *See* Books and Records Adopting Release, 84 FR at 68592.

- Are there potentially any restrictions or prohibitions on the ability of firms to maintain certain of those types of information? Are there potentially any restrictions on the ability of the Commission to access particular types of records?
- Are firms required to furnish records promptly to regulators upon request?

The Staff suggests that you also address generally the comparability of your jurisdiction's requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

As noted above, the Exchange Act includes provisions related to the creation and maintenance of certain records, including daily trading records.¹¹⁶

Commission rules incorporate a number of elements regarding how long particular records must be preserved, and accessibility of records, and related matters. For example, security-based swap dealers and major security-based swap participants are required to maintain for at least six years, the first two years in an easily accessible place, the above records related to trade blotters, ledgers, ledger accounts and security records/ledgers.¹¹⁷

Under Commission rules, dealers and major participants further are required to maintain the following types of records for at least three years, the first two years in an easily accessible place: certain information required to be made pursuant to rule 18a-5,¹¹⁸ certain cash-related

¹¹⁶ See notes 96-97, *supra*, and accompanying text.

¹¹⁷ Exchange Act rule 18a-6(a)(1) [17 CFR 240.18a-6(a)(1)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-6(a)(2) [17 CFR 240.18a-6(a)(2)] (for dealers and major participants with a prudential regulator).

¹¹⁸ Exchange Act rule 18a-6(b)(1)(i) [17 CFR 240.18a-6(b)(1)(i)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-6(b)(2)(i) [17 CFR 240.18a-6(b)(2)(i)]. (for dealers and major participants with a prudential regulator). These provisions address the preservation of records related to the above information related to brokerage orders/instructions, security-based swap transactions for the firm account, confirmations and trade acknowledgments/verifications, security-based swap counterparty information, options positions, trial balances, current exposure calculations, segregation, non-verified security-based swaps, business conduct compliance, and risk mitigation compliance. This portion of the record preservation requirement does not address the recordmaking requirement related to associated persons.

records and bills,¹¹⁹ communications,¹²⁰ net capital-related information,¹²¹ account documents,¹²² written agreements,¹²³ information supporting financial statements,¹²⁴ risk management

¹¹⁹ In part, this encompasses check books, bank statements, cancelled checks and cash reconciliations. *See* Exchange Act rule 18a-6(b)(1)(ii) [17 CFR 240.18a-6(b)(1)(ii)]. This also encompasses information regarding bills receivable and payable, related to the business of the security-based swap dealer and major security-based swap participant as such. *See* Exchange Act rule 18a-6(b)(1)(iii) [17 CFR 240.18a-6(b)(1)(iii)]. These requirements apply only to dealers and major participants without a prudential regulator.

¹²⁰ Exchange Act rule 18a-6(b)(1)(iv) [17 CFR 240.18a-6(b)(1)(iv)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-6(b)(2)(ii) [17 CFR 240.18a-6(b)(2)(ii)] (for dealers and major participants with a prudential regulator). These provisions require preservation of originals of communications received and copies of communications sent (and approvals of communications sent), including inter-office memoranda and communications, as well as sales scripts and recordings of telephone calls required to be maintained pursuant to Exchange Act section 15F(g)(1) (related to daily trading records).

¹²¹ Exchange Act rule 18a-6(b)(1)(v) [17 CFR 240.18a-6(b)(1)(v)]. This provision requires preservation of trial balances, computations of net capital and tangible net worth (and related working papers), financial statements, branch office reconciliations, and internal audit working papers relating to the business of the security-based swap dealer and major security-based swap participant as such. This requirement applies only to dealers and major participants without a prudential regulator.

¹²² Exchange Act rule 18a-6(b)(1)(vi) [17 CFR 240.18a-6(b)(1)(vi)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-6(b)(2)(iii) [17 CFR 240.18a-6(b)(2)(iii)] (for dealers and major participants with a prudential regulator). These provisions require preservation of guarantees of accounts and powers of attorney and other evidence of the granting of any discretionary authority given in respect of any account, as well as copies of resolutions empowering an agent to act on behalf of a corporation.

¹²³ Exchange Act rule 18a-6(b)(1)(vii) [17 CFR 240.18a-6(b)(1)(vii)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-6(b)(2)(iv) [17 CFR 240.18a-6(b)(2)(iv)] (for dealers and major participants with a prudential regulator). These provisions require preservation of written agreements (or copies) relating to the security-based swap dealer and major security-based swap participant's business as such, including agreements with respect to any account. Written agreements with respect to a security-based swap customer or non-customer – including governing documents or any document establishing the terms and conditions of the security-based swaps – must be maintained with the account records of the customer or non-customer.

¹²⁴ Exchange Act rule 18a-6(b)(1)(viii) [17 CFR 240.18a-6(b)(1)(viii)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-6(b)(2)(v) [17 CFR 240.18a-6(b)(2)(v)] (for dealers and major participants with a prudential regulator). These provisions require preservation of records containing information supporting amounts included in FOCUS reports and in required financial statements, including money balances, positions in securities, futures, commodities and options, and records relating to margin and segregation. This requirement applies only to dealers and major participants without a prudential regulator, except for the segregation-related possession or control information.

records,¹²⁵ credit risk determinations,¹²⁶ information related to Regulation SBSR,¹²⁷ and information related to business conduct and special entity requirements.¹²⁸

Commission rules also require firms to maintain certain additional records for the life of the enterprise and any successor enterprise.¹²⁹ The rules further require firms to maintain and preserve certain types of records in an easily accessible place: information regarding associated persons,¹³⁰ records related to orders of settlement,¹³¹ compliance, supervisory and procedures

¹²⁵ Exchange Act rule 18a-6(b)(1)(ix) [17 CFR 240.18a-6(b)(1)(ix)]. This provision requires preservation of records and results of periodic reviews associated with risk management requirements. This requirement applies only to dealers and major participants without a prudential regulator.

¹²⁶ Exchange Act rule 18a-6(b)(1)(x) [17 CFR 240.18a-6(b)(1)(x)]. This provision requires preservation of records regarding the basis for the firm's internal credit assessments of counterparties for purposes of the credit risk charges it must take as part of its net capital computation. This provision applies only to dealers and major participants without a prudential regulator.

¹²⁷ Exchange Act rule 18a-6(b)(1)(xi) [17 CFR 240.18a-6(b)(1)(xi)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-6(b)(2)(vi) [17 CFR 240.18a-6(b)(2)(vi)] (for dealers and major participants with a prudential regulator). These provisions require preservation of information the firm is required to submit to a repository pursuant to Regulation SBSR.

¹²⁸ Exchange Act rule 18a-6(b)(1)(xii), (xiii) [17 CFR 240.18a-6(b)(1)(xii), (xiii)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-6(b)(2)(vii), (viii) [17 CFR 240.18a-6(b)(2)(vii), (viii)] (for dealers and major participants with a prudential regulator). These provisions require preservation of documents related to applicable business conduct standards, and documents used to make certain determinations with respect to special entities.

¹²⁹ Exchange Act rule 18a-6(c) [17 CFR 240.18a-6(c)]. This provision requires preservation of records such as partnership articles, articles of incorporation, minute books and stock certificate books (depending on the form of the legal entity); and copies of the applicable dealer and major participant registration forms (forms SBSE, SBSE-A, SBSE-C or SBSE-W), as well as amendments to those forms and other documentation showing the firm's registration with securities regulatory authorities or the CFTC.

¹³⁰ Exchange Act rule 18a-6(d)(1) [17 CFR 240.18a-6(d)(1)]. This provision requires preservation of the above information related to associated persons, until at least three years after the termination of the associated person's employment or other connection with the firm.

¹³¹ Exchange Act rule 18a-6(d)(2)(i) [17 CFR 240.18a-6(d)(2)(i)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-6(d)(2)(ii) [17 CFR 240.18a-6(d)(2)(ii)] (for dealers and major participants with a prudential regulator). These provisions require preservation of reports that a securities regulatory authority or the CFTC (or a prudential regulator, if applicable) has required the firm to make and furnish pursuant to an order of settlement, and related examinations reports until three years after the date of the report.

manuals,¹³² and records related to the risk mitigation requirements.¹³³ The rules also include provisions relating to the use of electronic storage systems,¹³⁴ third-party contractors,¹³⁵ and the prompt production of records.¹³⁶

D. Reports and notifications

The recordkeeping and reporting regulatory requirements in part address the reports and notices that firms must provide regarding their financial condition and regarding operational issues and deficiencies, as necessary to provide for effective Commission oversight of registered entities.

Your jurisdiction's requirements

Relevant information for the discussion regarding your jurisdiction's requirements related to reports and notices that firms are required to make may include (along with other relevant factors):

- What reports are firms required to make regarding financial, operational and compliance matters? To what extent is the information associated with those requirements similar to, or

¹³² Exchange Act rule 18a-6(d)(3)(i) [17 CFR 240.18a-6(d)(3)(i)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-6(d)(3)(ii) [17 CFR 240.18a-6(d)(3)(ii)] (for dealers and major participants with a prudential regulator). These provisions require preservation of compliance, supervisory and procedures manuals related to compliance with applicable requirements and the supervision of associated natural persons, until three years after termination of the use of the manual. For firms with a prudential regulator, this requirement relates to compliance with laws and rules relating to security-based swap activities.

¹³³ Exchange Act rule 18a-6(d)(4), (5) [17 CFR 240.18a-6(d)(4), (5)]. These provisions require preservation of: written policies and procedures required under the risk mitigation requirements until three years after their termination; written portfolio reconciliation agreements until three years after the termination of the agreement and related transactions; trading relationship documentation until three years after the termination of the documentation and related transactions; and audit results related to trading relationship documentation until three years after the conclusion of the audit.

¹³⁴ The records required to be maintained and preserved may be produced by means of an electronic storage system, subject to a number of conditions including, *inter alia*, the capacity to readily download into the readable format the indexes and records preserved in the system, the use of duplicate records stored separately, an audit system, and undertakings by senior officers. *See* Exchange Act rule 18a-6(e) [17 CFR 240.18a-6(e)].

¹³⁵ If a security-based swap dealer or major security-based swap participant uses a third party to prepare or maintain records, the rule requires the third party to file an undertaking with the Commission stating, among other things, that the records are the property of the dealer or major participant and will be promptly furnished to the Commission or its designee. *See* Exchange Act rule 18a-6(f) [17 CFR 240.18a-6(f)].

¹³⁶ Security-based swap dealers and major security-based swap participants must furnish promptly to a representative of the Commission legible, true, complete, and current copies of records that the firm is required to make or preserve, that are requested by the representative of the Commission. *See* Exchange Act rule 18a-6(g) [17 CFR 240.18a-6(g)].

different from, the information presented in FOCUS reports, and in annual reports required under the Exchange Act?

- To what extent does your jurisdiction require reports that address the use of internal models for purposes of calculating net capital?
- Does your jurisdiction require firms to make financial and capital information publicly available online? If so, what are the contents of the required disclosures?
- What notices are firms required to make regarding matters such as capital adequacy and deficiencies, failures to comply with books and records requirements, failures to comply with segregation requirements, and material weaknesses?
- To what extent does your jurisdiction require financial reports or other information to be reviewed by an independent accountant?
- Are there potentially any restrictions or prohibitions on the ability of the Commission to access reports or notices made pursuant to the requirements of your jurisdiction?

The Staff suggests that you also address generally the comparability of your jurisdiction's requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

The Exchange Act provides that registered security-based swap dealers and major security-based swap participants must make reports that the Commission requires regarding transactions, positions and financial condition.¹³⁷

¹³⁷ Exchange Act section 15F(f)(1)(A) [15 U.S.C. 78o-10(f)(1)(A)].

Commission rules require security-based swap dealers and major participants to make a number of reports: “FOCUS reports,”¹³⁸ reports regarding the use of models to calculate net capital,¹³⁹ financial statements,¹⁴⁰ and annual reports.¹⁴¹

¹³⁸ Security-based swap dealers and major security-based swap participants are required to file FOCUS reports to provide the Commission with unaudited reports about their financial and operational condition. Exchange Act rule 18a-7(a)(1) [17 CFR 240.18a-7(a)(1)] (for dealers and major participants without a prudential regulator); Exchange Act rule 18a-7(a)(2) [17 CFR 240.18a-7(a)(2)] (for dealers and major participants with a prudential regulator).

¹³⁹ Dealers that have been authorized to use internal models to calculate net capital are required to file additional reports on a monthly or quarterly basis. Exchange Act rule 18a-7(a)(3) [17 CFR 240.18a-7(a)(3)].

¹⁴⁰ Dealers and major participants without a prudential regulator are required to disclose on their websites an audited statement of financial condition, and more recent unaudited statements. Exchange Act rule 18a-7(b)(1)(i), (2) [17 CFR 240.18a-7(b)(1)(i), (2)].

Dealers for which there is no prudential regulator also must disclose information regarding net capital, and if applicable, regarding material weaknesses identified by an accountant. Exchange Act rule 18a-7(b)(1)(ii), (iii) [17 CFR 240.18a-7(b)(1)(ii), (iii)].

¹⁴¹ Dealers and major participants without a prudential regulator annually must file a financial report with the Commission. Exchange Act rule 18a-7(c)(1)(i)(A) [17 CFR 240.18a-7(c)(1)(i)(A)]; *see also* Exchange Act rule 18a-7(c)(2) [17 CFR 240.18a-7(c)(2)] (addressing required contents of the financial report).

Dealers further are required to file, as applicable, a report addressing the firm’s compliance with or exemption from segregation requirements. Exchange Act rule 18a-7(c)(1)(i)(B) [17 CFR 240.18a-7(c)(1)(i)(B)]; *see also* Exchange Act rule 18a-7(c)(3), (4) [17 CFR 240.18a-7(c)(3), (4)] (addressing required contents of compliance and exemption reports). In addition, firms are required to file reports of an independent public accountant addressing the financial report and the segregation-related report. Exchange Act rule 18a-7(c)(1)(i)(C) [17 CFR 240.18a-7(c)(1)(i)(C)].

The rule contains additional provisions regarding, *inter alia*, the nature and form of reports, accountant qualifications and engagement, and notifications of non-compliance or material weakness. Exchange Act rule 18a-7(d)-(g) [17 CFR 240.18a-7(d)-(g)]

Commission rules further require firms to provide notices regarding: capital deficiencies,¹⁴² bank dealers' capital category adjustments,¹⁴³ failures regarding books and records,¹⁴⁴ material weaknesses,¹⁴⁵ and failures to make required reserve account deposits.¹⁴⁶

¹⁴² Security-based swap dealers without a prudential regulator must notify the Commission if the dealer's net capital falls below the minimum amount required. Exchange Act rule 18a-8(a)(1) [17 CFR 240.18a-8(a)(1)]. Major security-based swap participants without a prudential regulator must give notice if its tangible net worth falls below the applicable requirement. Exchange Act rule 18a-8(a)(2) [17 CFR 240.18a-8(a)(2)]. Notice must be provided promptly, but within 24 hours, based on a number of triggering events. Exchange Act rule 18a-8(b) [17 CFR 240.18a-8(b)].

¹⁴³ Every security-based swap dealer with a prudential regulator is required to give notice to the Commission when the dealer files an adjustment of reported capital category with its prudential regulator. Exchange Act rule 18a-8(c) [17 CFR 240.18a-8(c)].

¹⁴⁴ Every dealer or major participant that fails to make and keep current the required books and records must notify the Commission on the day that the failure arises, and, within forty-eight hours of the original notice, provide a report stating what the firm has done or is doing to correct the situation. Exchange Act rule 18a-8(d) [17 CFR 240.18a-8(d)].

¹⁴⁵ Every dealer or major participant without a prudential regulator that discovers a material weakness, or is notified by an independent public accountant of a material weakness, must notify the Commission within twenty-four hours, and transmit a report within forty-eight hours of the notice stating what the firm has done or is doing to correct the situation. Exchange Act rule 18a-8(e) [17 CFR 240.18a-8(e)].

¹⁴⁶ Every dealer must give notice to the Commission if the dealer fails to make a deposit into its customer reserve account, as required by the segregation rule. Exchange Act rule 18a-8(g) [17 CFR 240.18a-8(g)].

III. Supervision and chief compliance officer requirements

The supervision and chief compliance officer requirements promote registered entities' use of structures, processes and responsible personnel reasonably designed to promote compliance with applicable law and to identify and cure instances of non-compliance.¹⁴⁷ These entity-level requirements generally apply to the entirety of a firm's security-based swap business, regardless of the location of the business or counterparty.¹⁴⁸

Those consist of the following requirements:¹⁴⁹

- *Diligent supervision* – as provided by Exchange Act section 15F(h)(1)(B) [15 U.S.C. 78o-10(h)(1)(B)] and Exchange Act rule 15Fh-3(h) [17 CFR 240.15Fh-3(h)].
- *Chief compliance officers* – as provided by Exchange Act section 15F(k) [15 U.S.C. 78o-10(k)] and Exchange Act rule 15Fk-1 [17 CFR 240.15Fk-1].

A. Criteria for assessing comparability

Consistent with the holistic approach toward assessing the comparability of regulatory outcomes in connection with substituted compliance, the comparability assessment associated with these requirements may focus on the comparability of individual requirements or, alternatively, may focus on whether the analogous requirements of a foreign jurisdiction – taken as a whole – produce similar outcomes as Exchange Act requirements with regard to the overall goal of ensuring that registered entities have structures and processes reasonably designed to promote compliance with applicable law and to identify and cure instances of non-compliance, in part through the designation of an individual with responsibility and authority over compliance matters. This latter approach does not require that the foreign jurisdiction have analogues to

¹⁴⁷ In proposing the supervisory rules, the Commission drew analogies to the fundamental importance of supervision in the broker-dealer context. “The Commission has long emphasized that the responsibility of broker-dealers to supervise their employees is a critical component of the federal regulatory scheme. * * * In large organizations it is especially imperative that those in authority exercise particular vigilance when indications of irregularity reach their attention. The supervisory obligations imposed by the federal securities laws require a vigorous response even to indications of wrongdoing.” See Exchange Act Release No. 64766 (Jun. 29, 2011), 76 FR 42396, 42419 n.158 (Jul. 18, 2011) (citing John H. Gutfreund, Exchange Act Release No. 31554 (Dec. 3, 1992) (report pursuant to Section 21(a) of the Exchange Act)).

The Commission also noted that the proposed chief compliance officer requirements “underscore the central role that sound compliance programs play to ensure compliance with the Exchange Act and rules and regulations thereunder applicable to security-based swaps.” See *id.* at 42435.

¹⁴⁸ “[I]t is appropriate to subject a registered [entity] to the diligent supervision requirements regardless of the status or location of its counterparties to ensure that the [entity] is adequately supervising its business and its associated persons to ensure compliance with the full range of its obligations under the federal securities laws.” Business Conduct Adopting Release, 81 FR at 30064.

¹⁴⁹ For further information regarding these requirements, see *generally* Business Conduct Adopting Release, note 6, *supra*.

every requirement under Commission rules, as long as the overall requirements of a foreign jurisdiction provide similar regulatory outcomes.

The comparability analysis, however, also should account for the fact that Exchange Act section 15F sets forth certain requirements regarding chief compliance officer designation, duties and annual reports with a degree of specificity.

Exchange Act rule 3a71-6(d)(1) [17 CFR 240.3a71-6(d)(1)] further provides in relevant part that in making substituted compliance determinations with regard to supervision requirements the Commission intends to consider whether “the mandates for supervisory systems under the requirements of the foreign financial regulatory system, and the duties imposed by the foreign financial regulatory system” are comparable to those associated with the applicable Exchange Act provisions and underlying rules.

In addition, Exchange Act rule 3a71-6(d)(2) [17 CFR 240.3a71-6(d)(2)] provides that in making substituted compliance determinations with regard to chief compliance officer requirements the Commission intends to consider whether “the requirements of the foreign financial regulatory system regarding chief compliance officer obligations” are comparable to those required pursuant to the applicable Exchange Act provisions and underlying rules.

B. Supervisory systems, responsible individuals and qualified supervisors

The supervision and chief compliance officer requirements in part address the need for firms to have internal supervision systems with qualified supervisory personnel.

Your jurisdiction’s requirements

Relevant information for the discussion regarding your jurisdiction’s requirements regarding the establishment of supervisory or compliance systems, including requirements related to supervisory authority and the qualification of supervisors, may include (along with other relevant factors):

- To what extent are firms required to have systems for the internal supervision of their security-based swap business and personnel? How are those systems required to be reasonably designed to prevent violations of the applicable laws? How is the effectiveness of those systems assessed?
- What requirements govern firms’ designation of supervisory personnel, and the authority, responsibility and capacity of those personnel?
- What requirements govern the qualification of supervisory personnel?

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

Exchange Act section 15F(h)(1)(B) [15 U.S.C. 78o-10(h)(1)(B)] requires that security-based swap dealers and major security-based swap participants conform with rules that the Commission prescribes with regard to diligent supervision of the firm's business.

Under Commission rules, dealers and major participants must: establish and maintain supervisory systems,¹⁵⁰ designate at least one person with authority to carry out supervisory responsibilities,¹⁵¹ and make use of supervisors that are qualified to carry out their responsibilities.¹⁵²

C. Supervisory system policies and procedures

The supervision and chief compliance officer requirements in part address the need for firms to establish, maintain and enforce written supervisory policies and procedures that reasonably are designed to prevent violations of applicable law.

Your jurisdiction's requirements

Relevant information for the discussion regarding your jurisdiction's requirements related to supervisory policies and procedures may include (along with other relevant factors):

- In what ways are firms required to establish, maintain and enforce written supervisory policies and procedures?
- In what ways are firms required to have supervisory policies and procedures for the review of transactions?
- In what ways are firms required to have supervisory policies and procedures for the review of correspondence and internal communications? Are firms also required to have supervisory policies and procedures for the supervision of oral communications?
- In what ways are firms required to have supervisory policies and procedures for annual or periodic review that are intended to prevent and detect violations of applicable law?
- In what ways are firms required to have supervisory policies and procedures for investigating the character, business repute, qualifications, and experience of associated persons?
- In what ways are firms required to have supervisory policies and procedures for approving and supervising the outside trading of associated persons?

¹⁵⁰ Under Commission rules, each dealer and major participant is required to “establish and maintain a system to supervise, and shall diligently supervise,” its business and the activities of its associated persons relating to security-based swaps. The system must “be reasonably designed to prevent violations of the provisions of applicable federal securities laws and the rules and regulations thereunder” relating to the firm's business. Exchange Act rule 15Fh-3(h)(1) [17 CFR 240.15Fh-3(h)(1)].

¹⁵¹ Exchange Act rule 15Fh-3(h)(2)(i) [17 CFR 240.15Fh-3(h)(2)(i)] (also stating that the designation requirement applies to each type of business for which registration is required).

¹⁵² Exchange Act rule 15Fh-3(h)(2)(ii) [17 CFR 240.15Fh-3(h)(2)(ii)] (further providing that qualification may be established via experience or training).

- Are firms required to have supervisory policies and procedures to generally prevent self-supervision, and to address self-supervision when it is unavoidable? What factors must be met to conclude that self-supervision is unavoidable?
- In what ways are firms required to have supervisory policies and procedures to prevent the supervisory system from being compromised due to conflicts of interest?
- When are firms required to amend their policies and procedures?
- What is the potential liability that firms or their personnel may face for failing to supervise compliance with applicable requirements applicable to their security-based swap businesses? Does following policies and procedures provide a safe harbor from this potential liability or otherwise reduce the potential liability? If so, what are the prerequisites (*e.g.*, no “red flags”) for that safe harbor or reduction of liability?

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

Commission rules require that dealers and major participants establish, maintain and enforce written policies and procedures that address the firm’s security-based swap business, including associated persons. Those policies and procedures must be “reasonably designed to prevent violations” of applicable securities laws and regulations.¹⁵³

Under Commission rules, those policies and procedures at a minimum¹⁵⁴ must include elements regarding: transaction review,¹⁵⁵ correspondence and internal communication review,¹⁵⁶

¹⁵³ Exchange Act rule 15Fh-3(h)(2)(iii) [17 CFR 240.15Fh-3(h)(2)(iii)].

¹⁵⁴ In adopting these requirements, the Commission noted that the minimum requirements listed in the rule “are not an exhaustive list,” and that entities “should keep in mind their overarching obligation . . . to establish and maintain a supervisory system that is reasonably designed to prevent violations of applicable federal securities laws and the rules and regulations thereunder” relating to the firm’s security-based swap business. *See* Business Conduct Adopting Release, 81 FR at 30005-06 (suggesting that entities “generally should consider” providing for the supervisory review of oral communications if those are recorded, and that entities should consider how to supervise certain disclosures that are made by oral communication).

¹⁵⁵ Exchange Act rule 15Fh-3(h)(2)(iii)(A) [17 CFR 240.15Fh-3(h)(2)(iii)(A)] (mandating procedures for supervisory review of transactions for which registration as a dealer or major participant is required).

¹⁵⁶ Exchange Act rule 15Fh-3(h)(2)(iii)(B) [17 CFR 240.15Fh-3(h)(2)(iii)(B)] (requiring procedures for supervisory review of incoming and outgoing written – including electronic – correspondence with counterparties or potential counterparties, and of internal written communications relating to the firm’s security-based swap business).

periodic business review,¹⁵⁷ the character and qualifications of personnel,¹⁵⁸ outside trading by personnel,¹⁵⁹ supervisory system descriptions,¹⁶⁰ prohibitions against self-supervision,¹⁶¹ and conflict of interest provisions.¹⁶² Firms must amend their written supervisory procedures as appropriate based on material changes in applicable laws or regulations, or in the firm’s business or supervisory system.¹⁶³

Commission rules also provide that the supervisory system must encompass procedures for compliance with duties set forth in Exchange Act section 15F(j).¹⁶⁴ Section 15F(j) contains self-executing requirements that, *inter alia*, impose on security-based dealers and major security-based swap participants duties related to: establishing robust and professional risk management

¹⁵⁷ Exchange Act rule 15Fh-3(h)(2)(iii)(C) [17 CFR 240.15Fh-3(h)(2)(iii)(C)] (requiring procedures for periodic review, at least annually, of the firm’s security-based swap business “that is reasonably designed to assist in detecting and preventing violations” of applicable requirements).

¹⁵⁸ Exchange Act rule 15Fh-3(h)(2)(iii)(D) [17 CFR 240.15Fh-3(h)(2)(iii)(D)] (requiring procedures for investigation of “the good character, business repute, qualifications, and experience” of persons prior to their association with the firm).

¹⁵⁹ Exchange Act rule 15Fh-3(h)(2)(iii)(E) [17 CFR 240.15Fh-3(h)(2)(iii)(E)] (requiring procedures to consider whether associated persons may establish or maintain securities or commodities accounts or trading relationships at other firms, and, if permitted, procedures for the supervision of that outside trading).

¹⁶⁰ Exchange Act rule 15Fh-3(h)(2)(iii)(F) [17 CFR 240.15Fh-3(h)(2)(iii)(F)] (requiring a description of the supervisory system, including the titles, qualifications, locations and responsibilities of supervisory persons).

¹⁶¹ Exchange Act rule 15Fh-3(h)(2)(iii)(G) [17 CFR 240.15Fh-3(h)(2)(iii)(G)] requires procedures prohibiting an associated person who performs a supervisory function from supervising his or her own activities or reporting to, or having his or her compensation or continued employment determined by, a person or persons he or she is supervising.

This prohibition does not apply if the firm determines compliance is not possible “because of the firm’s size or a supervisory person’s position within the firm.” In that case the firm must document the factors used to reach that determination, and how the supervisory arrangement with respect to that supervisory personnel otherwise complies with the diligent supervision requirement.

¹⁶² Exchange Act rule 15Fh-3(h)(2)(iii)(H) [17 CFR 240.15Fh-3(h)(2)(iii)(H)] (requiring procedures reasonably designed to prevent the supervisory system from being compromised due to the conflicts of interest that may be present with respect to associated persons, including their positions, the revenue they generate, or compensation that the supervisor may derive from the associated person being supervised).

¹⁶³ Exchange Act rule 15Fh-3(h)(4) [17 CFR 240.15Fh-3(h)(4)] (also requiring that firms promptly communicate material amendments to relevant associated persons).

¹⁶⁴ See Exchange Act rule 15Fh-3(h)(2)(iii)(I) [17 CFR 240.15Fh-3(h)(2)(iii)(I)].

systems,¹⁶⁵ disclosing certain security-based swap information to regulators,¹⁶⁶ obtaining necessary information,¹⁶⁷ implementing conflict-of-interest systems and procedures,¹⁶⁸ and addressing antitrust considerations.¹⁶⁹

In addition, Commission rules provide that a firm or its associated person will not be deemed to have failed to diligently supervise another person if the firm establishes, maintains and applies written policies and procedures that would reasonably be expected to prevent and detect violations, so long as the firm and its associated persons reasonably have discharged the associated duties and did not have a reasonable basis to believe that the policies and procedures were not being followed.¹⁷⁰

D. Chief compliance officer designation, reporting authority and job security

The supervision and chief compliance officer requirements in part address the need for firms to designate individuals with responsibility and adequate authority over compliance matters.

Your jurisdiction's requirements

Relevant information for the discussion regarding your jurisdiction's requirements regarding the designation of individuals with responsibility and authority over compliance matters may include (along with other relevant factors):

¹⁶⁵ Exchange Act section 15F(j)(2) [15 U.S.C. 78o-10(j)(2)]; *see also* note 63, *supra*, and accompanying text (regarding risk management system requirements for nonbank dealers and major participants).

¹⁶⁶ Exchange Act section 15F(j)(3) [15 U.S.C. 78o-10(j)(3)] requires firms to disclose, to the Commission and prudential regulators, information concerning: terms and conditions of its security-based swaps; security-based swap trading operations, mechanisms, and practices; financial integrity protections relating to security-based swaps; and other information relevant to the firm's trading in security-based swaps.

Substituted compliance is not available in connection with this disclosure duty. *See* Exchange Act rule 3a71-6(d)(1) [17 CFR 240.3a71-6(d)(1)] (generally making substituted compliance potentially available in connection with the business conduct and supervision requirements of Exchange Act sections 15F(h) and (j), but excluding, *inter alia*, section 15F(j)(3)).

¹⁶⁷ Exchange Act section 15F(j)(4) [15 U.S.C. 78o-10(j)(4)] requires firms to establish and enforce internal systems and procedures to obtain information needed to perform functions required by law or regulation, and to provide the information to the Commission and prudential regulators on request. Substituted compliance similarly is not available in connection with the information provision part of that duty. *See* Exchange Act rule 3a71-6(d)(1) [17 CFR 240.3a71-6(d)(1)] (further excluding section 15F(j)(4)(B) from the availability of substituted compliance).

¹⁶⁸ Exchange Act section 15F(j)(5) [15 U.S.C. 78o-10(j)(5)].

¹⁶⁹ Exchange Act section 15F(j)(6) [15 U.S.C. 78o-10(j)(6)].

Although section 15F(j) also addresses the monitoring of trading to prevent violations of applicable position limits, the Commission has not adopted any position limit requirements.

¹⁷⁰ Exchange Act rule 15Fh-3(h)(3) [17 CFR 240.15Fh-3(h)(3)].

- Are firms required to establish a chief compliance officer or similar function?
- How do the requirements of your jurisdiction address lines of reporting for the chief compliance officer or similar function? How do those requirements otherwise help ensure that those persons have necessary authority and resources?
- Do the requirements of your jurisdiction provide protections to the chief compliance officer or similar function with regard to removal, compensation or sanctioning? If so, what are those protections?

The Staff suggests that you also address generally the comparability of your jurisdiction's requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

The Exchange Act requires security-based swap dealers and major security-based swap participants to designate an individual to serve as a chief compliance officer.¹⁷¹ The Exchange Act further provides that the chief compliance officer is required to report "directly to the board of directors or to the senior officer" of the firm.¹⁷²

Under Commission rules, the compensation and removal of the chief compliance officer requires the approval of a majority of the firm's board of directors.¹⁷³

E. Chief compliance officer policies and procedures

The supervision and chief compliance officer requirements in part address the responsibility of chief compliance officers (or similar functions) to ensure that firms establish, follow and update appropriate compliance policies and procedures.

Your jurisdiction's requirements

Relevant information for the discussion regarding your jurisdiction's requirements regarding the obligation of chief compliance officers (or similar functions) with regard to compliance policies and procedures may include (along with any other relevant factors):

- Is the chief compliance officer or similar function required periodically to review the firm's compliance with applicable requirements? Is a written assessment required?
- Is the chief compliance officer or similar function required to ensure that the firm implements policies and procedures to remediate noncompliance? What methods are to be used to identify noncompliance?

¹⁷¹ Exchange Act section 15F(k)(1) [15 U.S.C. 78o-10(k)(1)]; *see also* Exchange Act rule 15Fk-1(a) [17 CFR 240.15Fk-1(a)].

¹⁷² Exchange Act section 15F(k)(2)(A) [15 U.S.C. 78o-10(k)(2)(A)]; *see also* Exchange Act rule 15Fk-1(b)(1) [17 CFR 240.15Fk-1(b)(1)].

¹⁷³ Exchange Act rule 15Fk-1(d) [17 CFR 240.15Fk-1(d)].

- Is the chief compliance officer or similar function required to take steps to resolve conflicts of interest? To what extent are board members or senior personnel required to participate in the resolution of conflicts of interest?
- Is the chief compliance officer or similar function required to administer all policies and procedures that are required by law?
- Are firms permitted to rely on another corporate officer to perform a similar function to a chief compliance officer? If so, to what extent is that job function similar the chief compliance officer job function described by Exchange Act requirements.

The Staff suggests that you also address generally the comparability of your jurisdiction's requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

The Exchange Act, as supplemented by Commission rules, sets forth requirements related to chief compliance officer duties with regard to firm policies and procedures. Those provisions address: a general requirement for written compliance policies and procedures,¹⁷⁴ required

¹⁷⁴ Exchange Act rule 15Fk-1(b)(2) [17 CFR 240.15Fk-1(b)(2)] requires the chief compliance officer to take "reasonable steps" to ensure that the firm "establishes, maintains and reviews written policies and procedures reasonably designed to achieve compliance with" the Exchange Act and underlying rules and regulations relating to its business as a dealer or major participant.

This rule implements Exchange Act section 15F(k)(2)(E) [15 U.S.C. 78o-10(k)(2)(E)], which generally requires the chief compliance officer to "ensure compliance" with the statute.

compliance reviews,¹⁷⁵ identifying and handling noncompliance,¹⁷⁶ resolution of conflicts of interest,¹⁷⁷ and administration of required policies and procedures.¹⁷⁸

F. Chief compliance officer reports

Finally, the supervision and chief compliance officer requirements address the need for chief compliance officers (or similar functions) to be responsible for appropriate periodic reports addressing compliance matters.

Your jurisdiction's requirements

Relevant information for the discussion regarding your jurisdiction's requirements regarding compliance reports may include (along with any other relevant factors):

¹⁷⁵ Exchange Act rule 15Fk-1(b)(2)(i) [17 CFR 240.15Fk-1(b)(2)(i)] requires the chief compliance officer to review the firm's compliance with respect to requirements under Exchange Act section 15F and underlying rules and regulations, "where the review shall involve preparing the registrant's annual assessment of its written policies and procedures reasonably designed to achieve compliance with" the statute and the rules by the dealer or major participant.

This rule implements Exchange Act section 15F(k)(2)(B) [15 U.S.C. 78o-10(k)(2)(B)], which generally requires the chief compliance officer to "review the compliance" of the firm.

¹⁷⁶ Exchange Act rule 15Fk-1(b)(2)(ii) [17 CFR 240.15Fk-1(b)(2)(ii)] requires the chief compliance officer to take reasonable steps to ensure that the firm "establishes, maintains and reviews" policies and procedures to remediate noncompliance issues that have been identified by means such as compliance office review, look-back, internal or external audit finding, self-reporting, and validated complaints. That rule implements Exchange Act section 15F(k)(2)(F) [15 U.S.C. 78o-10(k)(2)(F)], which generally requires the chief compliance officer to "establish procedures for the remediation of non-compliance" of issues that the chief compliance officer identified by those means.

In addition, Exchange Act rule 15Fk-1(b)(2)(iii) [17 CFR 240.15Fk-1(b)(2)(iii)] requires the chief compliance officer to take reasonable steps to ensure that the registrant establishes and follows procedures for the "handling, management response, remediation, retesting, and resolution" of non-compliance issues. That rule implements Exchange Act section 15F(k)(2)(G) [15 U.S.C. 78o-10(k)(2)(G)], which generally requires the chief compliance officer to "establish and follow appropriate procedures for the handling, management response, remediation, retesting, and closing of non-compliance issues."

¹⁷⁷ Exchange Act rule 15Fk-1(b)(3) [17 CFR 240.15Fk-1(b)(3)] requires the chief compliance officer, in consultation with the board of directors or the senior officer of the firm, to "take reasonable steps to resolve any material conflicts of interest that may arise."

This rule implements Exchange Act section 15F(k)(2)(C) [15 U.S.C. 78o-10(k)(2)(C)], which generally requires the chief compliance officer, in consultation with the board of directors or senior officers, to "resolve any conflicts of interest that may arise."

¹⁷⁸ Exchange Act rule 15Fk-1(b)(4) [17 CFR 240.15Fk-1(b)(4)] mandates that the chief compliance officer administer each policy and procedure that is required to be established.

This rule implements Exchange Act section 15F(k)(2)(D) [15 U.S.C. 78o-10(k)(2)(D)], which makes the chief compliance officer responsible for administering required policies and procedures.

- Are firms required to produce annual or other periodic compliance reports? If so, who is required to prepare them and what are the required contents? Are such reports required to disclose material non-compliance matters identified and the resources devoted to compliance efforts?
- Are compliance reports subject to certification and internal review requirements? If so, how?
- Are the required reports required to be submitted to the regulator? Are reports with material errors or omissions required to be amended?

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

The Exchange Act requires the chief compliance officer annually to prepare and sign a compliance report that contains a description of the security-based swap dealer’s or major security-based swap participant’s written compliance policies and procedures, including the code of ethics and conflict of interest policies.¹⁷⁹ The Exchange Act further requires that the compliance report accompany each appropriate financial report that the firm is required to furnish to the Commission, and include a certification that, under penalty of law, the report is accurate and complete.¹⁸⁰

Under Commission rules, the compliance report must describe elements related to: self-assessment of the effectiveness of the compliance policies and procedures,¹⁸¹ material changes to firm’s policies and procedures,¹⁸² areas for improvement,¹⁸³ material non-compliance matters identified,¹⁸⁴ and compliance resources and deficiencies.¹⁸⁵

¹⁷⁹ Exchange Act section 15F(k)(3)(A) [15 U.S.C. 78o-10(k)(3)(A)].

¹⁸⁰ Exchange Act section 15F(k)(3)(B) [15 U.S.C. 78o-10(k)(3)(B)].

¹⁸¹ Exchange Act rule 15Fk-1(c)(2)(i)(A) [17 CFR 240.15Fk-1(c)(2)(i)(A)].

¹⁸² Exchange Act rule 15Fk-1(c)(2)(i)(B) [17 CFR 240.15Fk-1(c)(2)(i)(B)].

¹⁸³ Exchange Act rule 15Fk-1(c)(2)(i)(C) [17 CFR 240.15Fk-1(c)(2)(i)(C)].

¹⁸⁴ Exchange Act rule 15Fk-1(c)(2)(i)(D) [17 CFR 240.15Fk-1(c)(2)(i)(D)].

¹⁸⁵ Exchange Act rule 15Fk-1(c)(2)(i)(E) [17 CFR 240.15Fk-1(c)(2)(i)(E)].

Commission rules further address the timing of submission,¹⁸⁶ internal distribution and discussion,¹⁸⁷ certification,¹⁸⁸ incorporation by reference,¹⁸⁹ and amendment of reports that have material errors or omissions.¹⁹⁰

¹⁸⁶ Exchange Act rule 15Fk-1(c)(2)(ii)(A) [17 CFR 240.15Fk-1(c)(2)(ii)(A)] (stating that the compliance report must be submitted to the Commission within 30 days following the deadline for filing the firm’s annual financial report to the Commission). Exchange Act rule 15Fk-1(c)(2)(iii) [17 CFR 240.15Fk-1(c)(2)(iii)] addresses extensions of time.

¹⁸⁷ Exchange Act rule 15Fk-1(c)(2)(ii)(B) [17 CFR 240.15Fk-1(c)(2)(ii)(B)] provides that the compliance report must be submitted to the firm’s directors and audit committee (or equivalent bodies) and senior officer prior to submission to the Commission.

Exchange Act rule 15Fk-1(c)(2)(ii)(C) [17 CFR 240.15Fk-1(c)(2)(ii)(C)] provides that the report also must be discussed in one or more meetings conducted by the senior officer with the chief compliance officer in the preceding 12 months, “the subject of which addresses” compliance obligations.

¹⁸⁸ Exchange Act rule 15Fk-1(c)(2)(ii)(D) [17 CFR 240.15Fk-1(c)(2)(ii)(A)] provides that the compliance report include a certification by the chief compliance officer or senior officer that, “to the best of his or her knowledge and reasonable belief and under penalty of law, the information contained in the compliance report is accurate and complete in all material respects.”

¹⁸⁹ Exchange Act rule 15Fk-1(c)(2)(iv) [17 CFR 240.15Fk-1(c)(2)(iv)].

¹⁹⁰ Exchange Act rule 15Fk-1(c)(2)(v) [17 CFR 240.15Fk-1(c)(2)(v)].

IV. Counterparty protection requirements

The counterparty protection requirements are intended to “bring professional standards of conduct to, and increase transparency in, the security-based swap market and to require registered [entities] to treat parties to these transactions fairly.”¹⁹¹ These transaction-level requirements generally apply only to a non-U.S. firm’s activities involving U.S. counterparties (unless the transaction is arranged, negotiated or executed in the United States).¹⁹²

Those consist of the following requirements:¹⁹³

- *Fair and balanced communications* – as provided by Exchange Act section 15F(h)(3)(C) [15 U.S.C. 78o-10(h)(3)(C)] and Exchange Act rule 15Fh-3(g) [17 CFR 240.15Fh-3(g)].
- *Disclosure of material risks and characteristics, and material incentives or conflicts of interest* – as provided by Exchange Act section 15F(h)(3)(B)(i), (ii) [15 U.S.C. 78o-10(h)(3)(B)(i), (ii)] and Exchange Act rule 15Fh-3(b) [17 CFR 240.15Fh-3(b)].
- *Disclosure of daily marks* – as provided by Exchange Act section 15F(h)(3)(B)(iii) [15 U.S.C. 78o-10(h)(3)(B)(iii)] and Exchange Act rule 15Fh-3(c) [17 CFR 240.15Fh-3(c)].
- *“Know your counterparty”* – as provided by Exchange Act rule 15Fh-3(e) [17 CFR 240.15Fh-3(e)].
- *Suitability of recommendations* – as provided by Exchange Act rule 15Fh-3(f) [17 CFR 240.15Fh-3(f)].
- *Disclosure of clearing rights* – as provided by Exchange Act rule 15Fh-3(d) [17 CFR 240.15Fh-3(d)].

¹⁹¹ See Business Conduct Adopting Release, 81 FR at 30065; see also Exchange Act Release No. 69490 (May 1, 2013), 78 FR 30968, 31010 (May 23, 2013) (proposed rules regarding cross-border application, stating that these requirements “primarily focus on protecting counterparties by requiring security-based swap dealers to, among other things, provide certain disclosures to counterparties, [and] adhere to certain standards of business conduct”).

Those are distinct from entity-level requirements that “primarily address concerns related to the security-based swap dealer as a whole, with a particular focus on safety and soundness of the entity to reduce systemic risk in the U.S. financial system.” See *id.* at 31011.

¹⁹² For non-U.S. security-based swap dealers, the business conduct requirements under Exchange Act section 15F(h) (other than internal supervision requirements) apply only to the dealer's transactions with U.S. counterparties (apart from certain transactions conducted through a foreign branch of the U.S. counterparty), or to transactions arranged, negotiated or executed in the United States. See Exchange Act rule 3a71-3(c) [17 CFR 240.3a71-3(c)] (exception from business conduct requirements for a security-based swap dealer’s “foreign business”); see also Exchange Act rules 3a71-3(a)(3), (8) and (9) [17 CFR 240.3a71-3(a)(3), (8) and (9)] (definitions of “transaction conducted through a foreign branch,” “U.S. business” and “foreign business”).

¹⁹³ For further information regarding these requirements, see generally Business Conduct Adopting Release, note 6, *supra*.

A. Criteria for assessing comparability

Consistent with the holistic approach toward assessing the comparability of regulatory outcomes in connection with substituted compliance, the comparability assessment associated with these requirements may focus on the comparability of individual requirements or, alternatively, may focus on whether the analogous requirements of a foreign jurisdiction – taken as a whole – produce similar outcomes as Exchange Act requirements with regard to the overall goals of promoting professional standards of conduct, increasing transparency and requiring registered entities to treat parties fairly. This latter approach does not require that the foreign jurisdiction have analogues to every requirement under Commission rules as long as the overall requirements of a foreign jurisdiction provide similar regulatory outcomes.

The comparability analysis for counterparty protection requirements, however, also must take into account that three relevant requirements under the Exchange Act – related to (1) fair and balanced communications, (2) disclosure of certain risks, characteristics, incentives and conflicts, and (3) disclosure of daily marks – specifically are mandated by Exchange Act section 15F.

Exchange Act rule 3a71-6(d)(1) [17 CFR 240.3a71-6(d)(1)] further provides in relevant part that in making substituted compliance determinations related to business conduct, the Commission intends to consider whether “the information that is required to be provided to counterparties pursuant to the requirements of the foreign financial regulatory system, the counterparty protections under the requirements of the foreign financial regulatory system, . . . and the duties imposed by the foreign financial regulatory system” are comparable to those associated with the applicable Exchange Act provisions and underlying rules.

B. Fair and balanced communications

The counterparty protection requirements in part address the need to promote complete and honest communications as part of firms’ security-based swap businesses.¹⁹⁴

Your jurisdiction’s requirements

Relevant information for the discussion regarding your jurisdiction’s requirements regarding the obligation of market participants to communicate in a complete and honest manner may include (along with other relevant factors):

- To what extent are firms prohibited from engaging in communications that are misleading in fact or by omission?
- To what extent are firms required to provide counterparties with information that is sufficient to promote informed decisionmaking?
- To what extent do relevant requirements address statements regarding past performance or predictions regarding future performance?

¹⁹⁴ In adopting the rules implementing this statutory requirement, the Commission expressed the view that the requirement promotes investor protection by prohibiting firms “from overstating the benefits or understating the risks to inappropriately influence counterparties’ investment decisions.” *See* Business Conduct Adopting Release, 81 FR at 30001-02.

- To what extent do relevant requirements mandate that certain types of communications be balanced by disclaimers and/or by contextual information?
- Are the relevant requirements lessened or otherwise modified in connection with certain categories of counterparties? If so, how?

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

The Exchange Act requires the Commission to adopt rules providing that security-based swap dealers and major security-based swap participants communicate with counterparties “in a fair and balanced manner based on principles of fair dealing and good faith.”¹⁹⁵

The Commission rule implementing that statutory provision specifies that: those communications must “provide a sound basis for evaluating the facts” with regard to particular security-based swaps or trading strategies; those communications “may not imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast”; and any statement referring to potential opportunities or advantages presented by a security-based swap must be balanced by “an equally detailed statement of the corresponding risks.”¹⁹⁶

C. Disclosure of material risks and characteristics, and material incentives or conflicts of interest

The counterparty protection requirements in part address the need for security-based swap market participants to have information that is sufficient to make informed decisions regarding potential transactions involving particular counterparties and particular financial instruments.¹⁹⁷

Your jurisdiction’s requirements

Relevant information for the discussion regarding your jurisdiction’s requirements regarding market participants’ obligation to provide counterparties with sufficient information concerning

¹⁹⁵ Exchange Act section 15F(h)(3)(C) [15 U.S.C. 78o-10(h)(3)(C)], Exchange Act rule 15Fh-3(g) [17 CFR 240.15Fh-3(g)].

¹⁹⁶ Exchange Act rule 15Fh-3(g) [17 CFR 240.15Fh-3(g)].

In adopting the rule implementing the fair and balanced communications requirement, the Commission noted that security-based swap dealers and major security-based swap participants “should also keep in mind that all their communications with counterparties will be subject to the specific antifraud provisions added to the Exchange Act under Title VII of the Dodd-Frank Act, as well as general antifraud provisions under the federal securities laws.” *See* Business Conduct Adopting Release, 81 FR at 30001. Substituted compliance is not available in connection with those antifraud provisions.

¹⁹⁷ In adopting the rule implementing this statutory requirement, the Commission stated that the objective of the required disclosure of material risks and characteristics is “to provide information to a counterparty to help them assess whether, and under what terms, they want to enter into the transaction.” *See id.* at 29985.

financial instruments, firm incentives and firm conflicts may include (along with other relevant factors):

- To what extent are firms required to provide counterparties or potential counterparties with information regarding the features of financial instruments? Is there required disclosure regarding the risks of financial instruments? Is there required disclosure regarding the terms of financial instruments?
- To what extent are firms required to provide counterparties or potential counterparties with information regarding the incentives or conflicts of interest facing the firms? Are firms required to disclose the revenue they receive from third parties?
- What provisions govern the timing and manner of required disclosure?
- Is the disclosure requirement lessened or eliminated in connection with certain categories of counterparties? If so, how?

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

The Exchange Act requires the Commission to adopt rules providing that security-based swap dealers and major security-based swap participants must disclose to counterparties – other than counterparties that are security-based swap dealers, major security-based swap participants, swap dealers or major swap participants – information regarding: the material risks and characteristics of the security-based swap; and any material incentives or conflicts of interest that the security-based dealer or major security-based swap participant may have in connection with the security-based swap.¹⁹⁸

The Commission rule implementing those statutory provisions further identifies the “material risks and characteristics” and “material incentives or conflicts of interest” to be disclosed.¹⁹⁹

¹⁹⁸ Exchange Act section 15F(h)(3)(B)(i), (ii) [15 U.S.C. 78o-10(h)(3)(B)(i), (ii)].

¹⁹⁹ “Material risks and characteristics” may include: (i) market, credit, liquidity, foreign currency, legal, operational, and other applicable risks; and (ii) material economic terms of the security-based swap, terms relating to the operation of the security-based swap, and the rights and obligations of the parties during the term of the security-based swap. Exchange Act rule 15Fh-3(b)(1) [17 CFR 240.15Fh-3(b)(1)].

“Material incentives or conflicts of interest” may encompass “any compensation or other incentives from any source other than the counterparty in connection with the security-based swap to be entered into with the counterparty.” Exchange Act rule 15Fh-3(b)(2) [17 CFR 240.15Fh-3(b)(2)].

In adopting the rule, the Commission noted that “incentives” does not refer “to any profit or return that the [entity] would expect to earn from the security-based swap itself, or from any related hedging or trading activities . . . but rather to any other financial arrangements pursuant to which [the entity] may have an incentive to encourage the counterparty to enter into the transaction.” See Business Conduct Adopting Release, 81 FR at 29986.

The rule also requires disclosure at a “reasonably sufficient time prior” to entering into the security-based swap, and requires disclosure in a “manner reasonably designed to allow the counterparty to assess” those risks, characteristics, incentives and conflicts, but states that the obligation does not apply unless “the identity of the counterparty is known” to the dealer or major participant “at a reasonably sufficient time prior to execution” to permit the disclosure.²⁰⁰

D. Daily mark disclosure

The counterparty protection requirements in part address the need for market participants to have effective access to daily mark information necessary to manage their security-based swap positions.²⁰¹

Your jurisdiction’s requirements

Relevant information for the discussion regarding your jurisdiction’s requirements regarding the disclosure of daily mark information may include (along with other relevant factors):

- To what extent are firms required to provide counterparties with daily mark information upon request or as a matter of course? How are daily marks calculated for those purposes?
- To what extent do firms also have to disclose underlying assumptions, methodologies or information sources related to daily mark calculations?
- Can firms restrict recipients’ use of this daily mark information, or charge recipients for the information?
- Is the disclosure requirement lessened or eliminated in connection with certain categories of counterparties? If so, how?

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

The Exchange Act requires the Commission to adopt rules providing that security-based swap dealers and major security-based swap participants must disclose to counterparties – other than certain types of dealers and major participants – daily mark information. For cleared security-

²⁰⁰ Exchange Act rule 15Fh-3(b) [17 CFR 240.15Fh-3(b)].

²⁰¹ In adopting the rule implementing that statutory requirement, the Commission noted that the daily mark disclosures “are relevant to a counterparty’s ongoing understanding and management of its security-based swap positions.” *See* Business Conduct Adopting Release, 81 FR at 29991.

Moreover, in rejecting the suggestion that certain counterparties be permitted to opt out of the receipt of daily mark disclosures, the Commission stated: “It is our understanding that counterparties have a range of sophistication and some are unlikely to have their own modeling capabilities or access to relevant data to calculate a daily mark themselves. We think it is appropriate to apply the rule so that counterparties receive the benefits of the daily mark and related disclosures, and do not think it appropriate to permit parties to ‘opt out’ of the benefits of those provisions.” *See id.* at 29990.

based swaps, this would encompass receipt of daily mark information from the clearing organization upon request of the counterparty. For uncleared security-based swaps, this would encompass receipt of the daily mark from the dealer or major participant.²⁰²

The Commission rule implementing that statutory provision further addresses the specific information that must be provided,²⁰³ and states that the dealer or major participant must provide the daily mark to the counterparty without charge or restrictions on internal use.²⁰⁴

E. “Know your counterparty”

The counterparty protection requirements in part accounts for the need that security-based swap dealers obtain essential counterparty information necessary to promote effective compliance and risk management.²⁰⁵

Your jurisdiction’s requirements

Relevant information for the discussion regarding your jurisdiction’s requirements regarding the need for market participants to obtain essential counterparty information necessary to promote compliance and risk management may include (along with other relevant factors):

- To what extent are firms required to obtain counterparty information necessary to promote compliance with applicable laws and regulations?
- To what extent are firms required to obtain counterparty information necessary for purposes of the firm’s credit and operational risk management policies?
- To what extent are firms required to obtain information regarding the authority of persons acting for the counterparty?
- Are such information gathering requirements lessened or eliminated in connection with certain categories of counterparties? If so, how?

²⁰² Exchange Act section 15F(h)(3)(B)(iii) [15 U.S.C. 78o-10(h)(3)(B)(iii)].

²⁰³ Under the rule, for cleared security-based swaps the security-based swap dealer or major security-based swap participant must disclose the daily mark received from the clearing agency upon counterparty request.

For uncleared security-based swaps, the dealer or major participant must disclose “the midpoint between the bid and offer, or the calculated equivalent thereof, as of the close of business, unless the parties agree in writing otherwise to a different time, on each business day during the term of the security-based swap.” That daily mark “may be based on market quotations for comparable security-based swaps, mathematical models or a combination thereof,” and the dealer or major participant must disclose its data sources and a description of the underlying methodology and assumptions, and promptly disclose any material changes to the data sources, methodology and assumptions during the term of the security-based swap.

²⁰⁴ Exchange Act rule 15Fh-3(c) [17 CFR 240.15Fh-3(c)].

²⁰⁵ In adopting this rule, the Commission expressed the view that the requirement “is consistent with basic principles of legal and regulatory compliance, and operational and credit risk management.” See Business Conduct Adopting Release, 81 FR at 29994.

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

Under Commission rules, security-based swap dealers must establish, maintain and enforce written policies and procedures “reasonably designed to obtain and retain a record of the essential facts concerning each counterparty whose identity is known to the security-based swap dealer that are necessary for conducting business with such counterparty.”

The rule further specifies that those “essential facts” are: facts required to “comply with applicable laws, regulations and rules”; facts required to implement the security-based swap dealer’s credit and operational risk management policies in connection with transactions involving the counterparty; and information regarding the authority of any person acting for the counterparty.²⁰⁶

F. Suitability

The counterparty protection requirements in part accounts for the need to guard against security-based swap dealers making unsuitable recommendations.²⁰⁷

Your jurisdiction’s requirements

Relevant information for the discussion regarding your jurisdiction’s requirements addressing a security-based swap dealer’s suitability obligations for recommended transactions and trading strategies may include (along with other relevant factors):

- To what extent are market participants prohibited from making unsuitable recommendations?
- What types of activities constitute “recommendations” or otherwise trigger the application of your jurisdiction’s suitability requirement?
- To what extent do firms and their personnel need to understand the risks and rewards of products subject to the suitability requirement?
- To what extent do firms and their personnel need to have a reasonable basis to conclude that the recommendation is suitable for the counterparty? What information must they obtain about the counterparty to comply with this requirement?
- Which counterparties are covered by your jurisdiction’s suitability requirement? To what extent is the suitability requirement excused or otherwise lessened in connection with certain types of counterparties, such as institutional counterparties?
- To what extent does the suitability requirement apply – or not apply – in connection with cross-border activities?

²⁰⁶ Exchange Act rule 15Fh-3(e) [17 CFR 240.15Fh-3(e)].

²⁰⁷ The Commission has noted that “the obligation to make only suitable recommendations is a core business conduct requirement for broker-dealers and other financial intermediaries.” *See* Business Conduct Adopting Release, 81 FR at 29997.

The Staff suggests that you also address generally the comparability of your jurisdiction’s requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

Under Commission rules, a security-based swap dealer that recommends²⁰⁸ a security-based swap, or a trading strategy involving a security-based swap, to a counterparty (other than a counterparty that is a dealer or major participant) must: undertake “reasonable diligence” to understand the potential risks and rewards associated with the recommendation; and have a “reasonable basis” to believe that the recommendation is suitable for the counterparty, based on information such as the counterparty’s investment profile, trading objectives and ability to absorb potential losses.²⁰⁹

A security-based swap dealer may fulfill that “reasonable basis” requirement with respect to an “institutional counterparty”²¹⁰ if: the dealer reasonably determines that the counterparty, or an agent with decision-making authority, is capable of independently evaluating investment risks; the counterparty or agent affirms it is exercising independent judgment; and the dealer discloses that it is acting as counterparty and is not assessing suitability.²¹¹

A security-based swap dealer may satisfy its “reasonable diligence” obligation if the dealer receives written representations that, for a counterparty that is not a special entity,²¹² the

²⁰⁸ The Commission has stated that determining whether a dealer has made a recommendation “should turn on the facts and circumstances of the particular situation.” In general, relevant factors include whether the communication “reasonably could be viewed as a ‘call to action’” and “reasonably would influence an investor to trade a particular security or group of securities.” *See* Business Conduct Adopting Release, 81 FR at 29997.

²⁰⁹ Exchange Act rule 15Fh-3(f)(1) [17 CFR 240.15Fh-3(f)(1)]

²¹⁰ For those purposes, “institutional counterparty” in part means an “eligible contract participant” (or “ECP”) other than certain types of ECPs such as non-financial corporations, benefit plans, government entities and individuals. The term “institutional counterparty” also encompasses other persons (including natural persons, corporations, partnerships and trusts) with at least \$50 million in total assets. *See* Exchange Act rule 15Fh-3(f)(4) [17 CFR 240.15Fh-3(f)(4)].

The term “eligible contract participant” is defined by Commodity Exchange Act section 1a(18) [7 U.S.C. 1a(18)]. The ECP definition subsumes, among other elements: corporations and other entities with more than \$10 million in assets; individuals with more than \$10 million invested on a discretionary basis (or \$5 million if hedging); entities with a net worth of at least \$1 million that are hedging commercial risk; financial institutions; insurance companies; certain investment companies; commodity pools with more than \$5 million in assets under management; certain employee benefit plans; governmental entities; certain brokers and dealers; and certain futures commission merchants.

²¹¹ Exchange Act rule 15Fh-3(f)(2) [17 CFR 240.15Fh-3(f)(2)].

²¹² The term “special entity” is defined to encompass: Federal agencies; certain state and local agencies and political subdivisions and instrumentalities; certain employee benefit plans and government plans; and endowments. *See* Exchange Act rule 15Fh-2(d) [17 CFR 240.15Fh-2(d)].

counterparty has complied with policies and procedures reasonably designed to ensure that the persons evaluating the recommendation and making trading decisions are capable of doing so.²¹³

G. Disclosure of clearing rights

Finally, the counterparty protection requirements address the information that market participants receive regarding their clearing rights under the Exchange Act.

Your jurisdiction's requirements

Relevant information for the discussion regarding your jurisdiction's requirements pertaining to clearing rights and the disclosure of any such clearing rights may include (along with other relevant factors):

- To what extent does your jurisdiction mandate the clearing of relevant transactions? In the absence of mandatory clearing of all transactions of a particular type, does your jurisdiction permit counterparties to elect to require clearing? If so, does the counterparty have the right to select the clearing agency?
- To what extent does your jurisdiction require disclosure of applicable clearing rights?

The Staff recommends that you also address generally the comparability of your jurisdiction's requirements and analogous requirements under the Exchange Act, including any general differences in the two sets of requirements, and the consistency of the objectives of the two sets of requirements.

Exchange Act requirements

Under Commission rules, security-based swap dealers and major security-based swap participants are required to disclose to a counterparty (other than a counterparty that is a dealer or major participant) certain information regarding clearing rights under the Exchange Act, so long as the identity of the counterparty is known to the dealer or major participant "at a reasonably sufficient time prior to execution of the transaction" to permit compliance.

Activities involving special entities are subject to heightened requirements under other rules. *See generally* Exchange Act rules 15Fh-4, 15Fh-5 [17 CFR 240.15Fh-4, 240.15Fh-5].

As discussed below, potential substituted compliance for the special entity requirements raises a number of additional issues. *See* Part V, *infra*.

²¹³ Rule 15Fh-3(f)(3) [17 CFR 240.15Fh-3(f)(3)].

The rule provides specific disclosure requirements for security-based swaps that are subject to mandatory clearing²¹⁴ and for other security-based swaps.²¹⁵ The rule further addresses records of disclosure.²¹⁶

²¹⁴ Exchange Act section 3C(a) [15 U.S.C. 78c-3(a)] requires the clearing of security-based swaps that are “required to be cleared,” contingent on the Commission designating which security-based swaps are subject to mandatory clearing. *See* Exchange Act section 3C(b) [15 U.S.C. 78c-3(b)]. The Commission has not made any such designations to date.

For security-based swaps that are subject to mandatory clearing, the dealer or major participant would have to: (i) disclose the names of the clearing agencies that accept the security-based swap, and identify which clearing agencies the dealer or major participant is authorized to use; and (ii) notify the counterparty that it has the sole right to select which clearing agency shall be used for clearing. Exchange Act rule 15Fh-3(d)(1) [17 CFR 240.15Fh-3(d)(1)].

²¹⁵ For security-based swaps that are not subject to mandatory clearing, the dealer or major participant must: (i) determine whether the security-based swap is accepted for clearing by one or more clearing agencies; (ii) disclose the names of the clearing agencies that accept the security-based swap, and identify which clearing agencies the dealer or major participant is authorized to use; and (iii) notify the counterparty that it may elect to require clearing and has the sole right to select the clearing agency (provided that the dealer or major participant is authorized to clear through that clearing agency). Exchange Act rule 15Fh-3(d)(2) [17 CFR 240.15Fh-3(d)(2)].

Exchange Act section 3C(g)(5) [15 U.S.C. 78c-3(g)(5)] in part provides – for security-based swaps that are not subject to mandatory clearing and that a security-based swap dealer or major security-based swap participant has entered into with a counterparty that is not a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant – that the counterparty may elect to require clearing of the security-based swap and shall have the sole right to select the clearing agency. Substituted compliance is not available in connection with this provision.

²¹⁶ Under the rule, the dealer or major participant must make a written record of non-written disclosures, and provide a written version of the disclosures “in a timely manner, but in any case no later than the delivery of the trade acknowledgement.” Exchange Act rule 15Fh-3(d)(3) [17 CFR 240.15Fh-3(d)(3)].

V. Additional requirements regarding eligible contract participant verification, special entities and political contributions

Additional section 15F(h) requirements

Apart from the requirements addressed above, there are additional requirements under Exchange Act section 15F(h) that potentially are eligible for substituted compliance.²¹⁷ As with other transaction-level requirements, those generally would apply only to a non-U.S. firm's activities involving U.S. counterparties (unless the transaction is arranged, negotiated or executed in the United States).²¹⁸

- *ECP verification.*

Exchange Act section 15F(h)(3)(A) [15 U.S.C. 78o-10(h)(3)(A)] and Exchange Act rule 15Fh-3(a)(1) [17 CFR 240.15Fh-3(a)(1)] require security-based swap dealers and major security-based swap participants to verify that their counterparties meet the standards to be eligible contract participants.²¹⁹

Compliance with this verification requirement reasonably may be expected to help inform firms when their potential counterparties are not ECPs, and hence promote compliance with statutory restrictions on entering into security-based swaps with non-ECP counterparties.²²⁰

- *Special entity provisions.*

Exchange Act sections 15F(h)(4) and (5) [15 U.S.C. 78o-10(h)(4) and (5)] and Exchange Act rules 15Fh-4 and 15Fh-5 [17 CFR 240.15Fh-4 and 240.15Fh-5] impose special requirements on security-based swap dealers in their capacity as advisors or counterparties to “special entities.”²²¹ The term “special entity” is defined to encompass Federal agencies, certain state and local agencies and political subdivisions and instrumentalities, certain employee benefit plans and government plans, and endowments.²²²

²¹⁷ Exchange Act rule 3a71-6(d)(1) [17 CFR 240.3a71-6(d)(1)] generally provides that substituted compliance may be available for business conduct requirements under Exchange Act section 15F(h).

²¹⁸ See note 192, *supra*.

²¹⁹ As noted above, the Commodity Exchange Act defines the term “eligible contract participant” to encompass a variety of types of persons. See note 210, *supra*.

²²⁰ See Exchange Act Section 6(l) (requiring security-based swaps with non-ECPs to be effected on a national securities exchange); Securities Act Section 5(e) (requiring registration of the offer and sale of security-based swaps to non-ECPs). Those restrictions are not eligible for substituted compliance.

²²¹ Exchange Act section 15F(h)(4)(A) and Exchange act rule 15Fh-4(a) also contain antifraud provisions that are not eligible for substituted compliance. See Exchange Act rule 3a71-6(d)(1).

²²² See Exchange Act rule 15Fh-2(d) [17 CFR 240.15Fh-2(d)]. The definition of “special entity” does not encompass non-U.S. persons. See Business Conduct Adopting Release, 81 FR at 30013.

Those special entity provisions reflect a statutory determination that certain categories of U.S. persons reasonably require heightened protection in connection with security-based swap activities.²²³

- *Political contributions.*

Exchange Act rule 15Fh-6 [17 CFR 240.15Fh-6] generally prohibits a security-based swap dealer from engaging in security-based swap transactions with a “municipal entity” within two years after certain political contributions have been made to officials of the municipal entity. For these purposes, the term “municipal entity” means any state, or political subdivision or municipal corporate instrumentality of a state, including, *inter alia*, related agencies, authorities or instrumentalities, plans and programs.²²⁴

This rule reflects that Commission’s concern that, absent such a prohibition, “pay to play practices may result in municipal entities entering into transactions not because of hedging needs or other legitimate purposes, but rather because of campaign contributions given to an official with influence over the selection process.”²²⁵

Special issues associated with substituted compliance for those requirements

The Commission has recognized that the unique features of those requirements raise special issues regarding the potential availability of substituted compliance:

The Commission further anticipates that certain categories of the requirements we are adopting today – related to ECP verification, special entities and political contributions – will raise special issues with regard to comparability, and with regard to whether adequate supervision and enforcement is available under the foreign regulatory regime. Such issues are likely to arise with regard to those particular requirements because each of those requirements [addresses] protections that may have no foreign law analogues, as those requirements reflect heightened concerns under U.S. law regarding potential abuses involving particular categories of persons. Indeed, those categories and the protections afforded to them under U.S. law may not correspond with any specified categories of persons or protections under relevant foreign law. As a result, substituted compliance assessments in connection with those categories will require inquiry regarding whether foreign regulatory requirements adequately reflect the same particular interests and protections.²²⁶

²²³ For example, security-based swap dealers that act as advisers to special entities have statutory duties to act in the special entity’s best interests, and to obtain information necessary to make a reasonable determination that recommendations are in the special entity’s best interest. *See* Exchange Act section 15F(h)(4) [15 U.S.C. 78o-10(h)(4)]. Dealers and major participants that act as counterparties to special entities have a statutory duty to have a reasonable basis to believe that the special entity has a qualified independent representative. *See* Exchange Act section 15F(h)(5) [15 U.S.C. 78o-10(h)(5)].

²²⁴ *See* Exchange Act section 15B(e)(8) [15 U.S.C. 78o-4(e)(8)] (incorporated by reference by Exchange Act rule 15Fh-6(a)(4)).

²²⁵ *See* Business Conduct Adopting Release, 81 FR at 30048.

²²⁶ *See* Business Conduct Adopting Release, 81 FR at 30076.

In light of these special issues, we recommend that any market participant or foreign financial regulatory authority that has an interest in pursuing substituted compliance in connection those requirements contact Commission staff to discuss the matter.²²⁷

The Staff looks forward to receiving applications for substituted compliance, and to working with the staff of foreign regulators to promote the regulatory efficiencies that would be associated with substituted compliance. As noted above, the detailed discussions regarding Exchange Act requirements in this Guidance are intended to promote analysis of regulatory similarities and differences, and facilitate complete applications that demonstrate how foreign requirements may produce comparable regulatory outcomes as analogous requirements under the Exchange Act. While specific explanations of foreign requirements will be useful toward achieving those goals, the analyses with regard to each applicable regulatory outcome “will focus on the comparability of regulatory outcomes rather than predicating substituted compliance on requirement-by-requirement similarity.”

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²²⁷ Such discussions would be expected to address, *inter alia*, whether there are foreign requirements that provide comparable safeguards as the Exchange Act analogues, notwithstanding differences in terminology used. For example, with regard to the ECP verification requirement, it would be helpful to know whether a foreign jurisdiction has counterparty verification rules that have the effect of capturing all non-ECPs, to help ensure that firms do not violate applicable statutory restrictions on entering into security-based swaps with non-ECP counterparties.

Similarly, in connection with the provisions regard transactions with and advice to “special entities,” it would be helpful to know whether there are analogous requirements applicable to protected classes of counterparties and advisees that have the effect of providing that all U.S. counterparties or advisees that are “special entities” are afforded at least the degree of protection that is required under the Exchange Act.