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Invested in America

September 5, 2014

Kevin M. O'Neill
Deputy Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers (Release No. 34-71958; File No. S7-05-14)

Dear Mr. O'Neill:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to provide the Securities and Exchange Commission ("**Commission**" or "**SEC**") with comments on the Commission's proposed recordkeeping, reporting, notification, and security count requirements for security-based swap dealers ("**SBSDs**"), major security-based swap participants ("**MSBSPs**"), and broker-dealers pursuant to Section 15F of the Securities Exchange Act of 1934 (the "**Exchange Act**"), as amended by Section 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank Act**"), and Section 17(a) of the Exchange Act ("**SEC Recordkeeping Proposal**").[2]

SIFMA appreciates the Commission's ongoing effort to implement the provisions of Title VII of the Dodd-Frank Act ("**Title VII**") that relate to security-based swaps. In this regard, we note that, in a number of places, the SEC Recordkeeping Proposal would prescribe recordkeeping or reporting requirements based on requirements in other rules that have been proposed by the Commission but have not yet been adopted, in particular requirements relating

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

[2] SEC Release No. 34-71958 (Apr. 17, 2014), 79 Fed. Reg. 25194 (May 2, 2014). As part of the same release, the Commission also solicits comments on a proposal to add a capital charge provision to proposed Rule 18a-1 under the Exchange Act that the Commission says was inadvertently omitted when that rule was originally proposed. *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, Release No. 34-68071 (Oct. 18, 2012), 77 Fed. Reg. 70214 (Nov. 23, 2012) ("**SEC Capital and Margin Proposal**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2012-11-23/pdf/2012-26164.pdf.

to capital, margin, and segregation for SBSDs and MSBSPs.[3] SIFMA has provided comments on many of these proposals, including the SEC Capital and Margin Proposal, and respectfully requests that the Commission consider all of those letters carefully before adopting any portion of the security-based swap regime established under Title VII of the Dodd-Frank Act.[4] In some cases where our previous comments are particularly relevant to the issues addressed in the SEC Recordkeeping Proposal, we have reiterated those comments below.

EXECUTIVE SUMMARY

The proposed recordkeeping, reporting, notification, and securities count requirements applicable to SBSDs and MSBSPs are designed to provide transparency into the business activities of SBSDs and MSBSPs, as well as assist the Commission in reviewing and monitoring compliance with the proposed capital, margin, and segregation requirements applicable to SBSDs and MSBSPs.[5] To accomplish this goal, the Commission has modeled the proposed rules

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[3] In addition, the SEC Recordkeeping Proposal includes proposed requirements related to the SEC's proposed trade acknowledgment rules, security-based swap reporting rules, and external business conduct rules for SBSD and MSBSP. *See* Trade Acknowledgment and Verification of Security-Based Swap Transactions, 76 Fed. Reg. 3859 (Jan. 21, 2011) ("**SEC Trade Acknowledgment Proposal**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2011-01-21/pdf/2011-1218.pdf; Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75208 (Dec. 2, 2010) ("**SEC Proposed Regulation SBSR**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2010-12-02/pdf/2010-29710.pdf; Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 Fed. Reg. 42396 (July 18, 2011), as corrected in 76 Fed. Reg. 46668 (Aug. 3, 2011), ("**SEC Business Conduct Proposal**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2011-07-18/pdf/2011-16758.pdf and http://www.gpo.gov/fdsys/pkg/FR-2011-08-03/pdf/C1-2011-16758.pdf.

[4] *See, e.g.,* SIFMA, the Futures Industry Association, and the International Swaps and Derivatives Association, Inc. comment letter to the SEC on business conduct standards for SBSDs and MSBSPs (Aug. 26, 2011) ("**SIFMA Comment Letter on SEC Business Conduct Standards Proposal**"), *available at:* http://www.sifma.org/issues/item.aspx?id=8589935219; SIFMA comment letter to the SEC on the registration of SBSDs and MSBSPs (Dec. 16, 2011) ("**SIFMA Comment Letter on SEC Registration Proposal**"), *available at:* http://www.sifma.org/issues/item.aspx?id=8589936792; SIFMA comment letter to the SEC on capital, margin, and segregation requirements for SBSDs and MSBSPs (Feb. 22, 2013) ("**SIFMA Comment Letter on SEC Capital and Margin Proposal**"), *available at:* http://www.sifma.org/issues/item.aspx?id=8589942116; and the SIFMA comment letter to U.S. Federal Agencies on margin requirements for non-centrally cleared swaps and security-based swaps (Mar. 12, 2014) ("**SIFMA Comment Letter on Margin for Uncleared Swaps**"), *available at:* http://www.sifma.org/issues/item.aspx?id=8589947977.

[5] Section 15F(e)(1)(B) of the Exchange Act, as added by Section 764 of the Dodd-Frank Act, provides that the Commission shall prescribe capital and margin requirements for SBSDs and MSBSPs that do not have a prudential regulator. Section 3E to the Exchange Act, as added by Section 763 of the Dodd-Frank Act, provides the Commission with authority to establish segregation requirements for all SBSDs and MSBSPs, regardless of whether they have a prudential regulator. *See* SEC Capital and Margin Proposal at 70215.

The term "**prudential regulator**" is defined in Section 1a(39) of the Commodity Exchange Act ("**CEA**") and that definition is incorporated by reference in Section 3(a)(74) of the Exchange Act. Pursuant to that definition, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the

on existing rules applicable to registered broker-dealers, with certain modifications to address the more limited activities of stand-alone SBSDs and stand-alone MSBSPs[6] and the Commission's more limited authority over SBSDs and MSBSPs that are banks subject to regulation by a prudential regulator ("**bank SBSD**" and "**bank MSBSP**").[7]

SIFMA understands the Commission's desire to establish a recordkeeping and reporting regime for SBSDs and MSBSPs that is designed to provide the Commission with transparency into the business activities of SBSDs and MSBSPs and assist the Commission in reviewing and monitoring compliance with the proposed capital, margin, and segregation requirements applicable to SBSDs and MSBSPs. While we support the Commission's goals, we believe that the proposed rules could be better designed to achieve these goals in a more efficient and cost effective manner.

At the outset, it is important to highlight one type of regulated entity that is not explicitly addressed in the SEC Recordkeeping proposal: broker-dealers who are registered as OTC derivatives dealers. Unlike other broker-dealers, and like stand-alone SBSDs, OTC derivatives dealers are not permitted to act as dealers with respect to all types of securities. The Commission should explicitly treat OTC derivatives dealers that dually register as SBSDs as stand-alone SBSDs that are approved to use internal models.

In addition, as we explain more fully in the discussion section of this letter, we recommend that:

Harmonization with Other Regulatory Regimes

- **Consistency with CFTC Recordkeeping and Reporting Rules.** The Commission should harmonize its recordkeeping and reporting requirements for SBSDs and MSBSPs with the CFTC's final recordkeeping and reporting rules for SDs and MSPs to the maximum extent possible, with the goal of permitting firms to utilize a single recordkeeping and reporting system for swaps and security-based swaps.

Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, or the Federal Housing Finance Agency is the prudential regulator of an SBSD or MSBSP if the entity is directly supervised by that agency.

[6] The Commission states its belief that stand-alone SBSDs and stand-alone MSBSPs will not engage in the same range of activities permitted to broker-dealers. For example, the Commission states that broker-dealers are permitted to act as dealers with respect to all types of securities, whereas stand-alone SBSDs would be permitted to act as dealers only with respect to security-based swaps. While this is true of stand-alone SBSDs established in the United States, SIFMA notes that it would not necessarily be true of foreign SBSDs, which may act as dealers in a wide range of securities outside of the United States and offer securities into the United States pursuant to Rule 15a-6 under the Exchange Act.

[7] Section 15F(f)(1)(B)(i) of the Dodd-Frank Act provides that SBSDs and MSBSPs for which there is a prudential regulator shall keep books and records of all activities related to their business as an SBSD or MSBSP in such form and manner and for such period as may be prescribed by the Commission by rule or regulation.

- **Deference to Recordkeeping and Reporting Rules Established by the Prudential Regulators**. The Commission should permit bank SBSDs and bank MSBSPs to satisfy the Commission's recordkeeping and reporting requirements by complying with recordkeeping and reporting rules established by their prudential regulator. These rules should be supplemented with additional requirements only to the extent that such additional obligations are necessary for the Commission to fulfill its limited oversight of the security-based swap activities of bank SBSDs and bank MSBSPs. Furthermore, the Commission should interpret the business of a bank as an SBSD or MSBSP narrowly, consistent with the Commission's limited regulatory interest in bank SBSDs and bank MSBSPs.

- **Deference to Recordkeeping and Reporting Rules Established by Foreign Regulators**. The Commission should permit a foreign SBSD or foreign MSBSP to satisfy its recordkeeping and reporting requirements by complying with recordkeeping and reporting rules established by its foreign regulator, provided such rules are comparable to Commission rules. Furthermore, the Commission should delay the cross-border application of its substantive requirements with respect to foreign SBSD and foreign MSBSP, including the proposed recordkeeping and reporting requirements, until the finalization of home jurisdiction regulations, plus the length of time it takes for the Commission to make an accompanying comparability determination.

Preliminary Considerations

- **Security-Based Swap Accounts**

    - ***General Considerations.*** The Commission should allow flexibility in how a "security-based swap account" is understood and operationalized to enable SBSDs and MSBSPs to have flexibility in how they keep and maintain required records relating to security-based swaps. Furthermore, the Commission should not define or interpret a "security-based swap account" in a way that would be inconsistent with the CFTC's concept of a "swap account."

    - ***Portfolio Margining and Cross-Margining.*** The Commission should not define a security-based swap account in such a way that an SBSD or MSBSP would be prevented from holding other types of securities in a security-based swap account. Furthermore, the Commission should build on existing precedent by working with the CFTC to facilitate the expansion of portfolio- and cross-margining arrangements.

- **Allocation of Duties.** The Commission should permit both U.S. and foreign SBSDs to allocate their Title VII obligations, including their obligations with respect to books and records, to an agent, provided that the SBSD ultimately remains responsible for compliance with the applicable requirements.

Recordkeeping

- **Transaction Information**

  - ***Trade Blotters.*** The Commission should make the use of legal entity identifiers ("**LEIs**") mandatory (subject to the qualification in footnote 25 below), although it should permit firms to use different counterparty identifiers for internal firm purposes as long as they are able to translate their internal counterparty identifiers into the standard LEI convention. Furthermore, the Commission should, as appropriate, provide SBSDs and MSBSPs flexibility in the manner in which they record security-based swap transactions, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be a record of original entry.

  - ***Memoranda of Brokerage Orders***. The Commission should confirm that the order ticket requirement only applies when there are in fact orders submitted for execution.

  - ***Memoranda of Proprietary Trades.*** The Commission should confirm that:

    - Order tickets are not required when the transactions are negotiated transactions; and

    - Although a U.S. broker-dealer will need to create and maintain trade tickets to the extent it participates in the execution of transactions as agent for an affiliated SBSD or MSBSP, the U.S. broker-dealer and its affiliated SBSD or MSBSP do not have to duplicate these records (*e.g.*, the affiliated SBSD could rely on records maintained by the registered broker-dealer).

  - ***Confirmations***. The Commission should harmonize its trade acknowledgement and verification proposal with the CFTC rules relating to trade acknowledgment. Furthermore, the Commission should not require a bank SBSD or bank MSBSP to make and keep current copies of all confirmations of purchases and sales of securities (other than security-based swaps), except as required by bank regulations. In the alternative, the Commission should narrowly interpret when securities transactions are "related to the business" of a bank as an SBSD or MSBSP.

  - ***Unverified Security-based Swap Transactions.*** The Commission should not establish a rigid five-day timeframe for obtaining verifications and instead should enter into a constructive dialogue with interested constituencies to establish best practices for trade verification. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.

- **Firm Records**

  - ***Option Positions.*** We support the Commission's proposal relating to recordkeeping for option positions, including its decision not to impose option positions recordkeeping requirements on bank SBSDs and bank MSBPs.

  - ***General Ledger***. The Commission should provide firms flexibility to keep general ledgers in various formats without mandating a particular format, so long as all required information is kept and accessible to the Commission.

  - ***Stock Record.*** The Commission should provide SBSDs and MSBSPs flexibility in the manner in which they create records for security-based swap transactions and not mandate a detailed specified format, particularly with respect to tracking collateral received and pledged, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be a record of the firm's security-based swap transactions. Furthermore, the Commission should allow sufficient time for firms to build out the necessary collateral systems.

- **Accounts**

  - ***Ledger Accounts.*** The Commission should allow flexibility in how a "ledger account" is understood and operationalized, and not mandate a detailed specified format, to enable SBSDs and MSBSPs to have flexibility in how they keep and maintain required records relating to security-based swaps. Furthermore, the Commission should not define or interpret a "ledger account" in a way that would be inconsistent with the CFTC's concept of a "ledger account."

  - ***Daily Margin Calculation.*** We support the Commission's proposed recordkeeping requirements relating to the daily margin calculation, but we request that the Commission consider the concerns that we raised regarding the Commission's margin proposal in the SIFMA Comment Letter on SEC Capital and Margin Proposal and the SIFMA Comment Letter on Margin for Uncleared Swaps.

- **Accountholder, Associated Persons, and Business Conduct**

  - ***Accountholder Information.*** The Commission should make the use of LEIs mandatory (subject to the qualification in footnote 25 below), although it should permit firms to use different counterparty identifiers for internal firm purposes as long as they are able to translate their internal counterparty identifiers into the standard LEI convention. Furthermore, the Commission should permit broker-dealers, SBSDs, and MSBSPs to satisfy the requirement to obtain signatures of persons authorized to trade on behalf of counterparties

by establishing policies and procedures relating to counterparty trade authorization.

- ***Associated Persons.*** The Commission should harmonize its proposal with the CFTC's approach to addressing the statutory disqualification prohibition for associated persons of SDs and MSPs. At a minimum, however, the Commission should modify the recordkeeping proposal to make it consistent with the SEC Registration Proposal and, therefore, only require an SBSD or MSBSP to obtain information from associated persons that effect or are involved in effecting security-based swaps on its behalf. The Commission also should remove or narrow the scope of, and provide exceptions from, the associated person investigation requirement. Furthermore, the Commission should limit the requirement for a bank SBSD or bank MSBSP to obtain information from every associated person whose "activities relate to the conduct of the business of the SBSD or MSBSP" to those associated persons who effect or are involved in effecting security-based swaps on its behalf.

- ***External Business Conduct Standards.*** The Commission should confirm that the SEC Recordkeeping Proposal is not proposing to create additional recordkeeping obligations with respect to business conduct standards set forth in the SEC Business Conduct Proposal, particularly with respect to the requirements relating to compliance with such requirements. Furthermore, the Commission should not adopt additional recordkeeping rules relating to the pay to play provisions proposed in the SEC Business Conduct Proposal.

- **Capital, Liquidity, and Customer Protection**

  - We understand the importance of recordkeeping and reporting for demonstrating compliance with the capital, liquidity, and customer protection requirements applicable to SBSDs and MSBSPs and, therefore, generally support the proposed recordkeeping and reporting requirements in connection with these requirements. However, as set forth below, we have technical and substantive concerns regarding the Commission's proposed capital, liquidity, and customer protection requirements.

  - We are particularly concerned that the proposal to require SBSDs to maintain net capital equal to 8% of their customer's security-based swap margin requirements (and for broker-dealer SBSDs, for this 8% margin factor to be added to their other minimum net capital requirements) would require the maintenance of resources far in excess of the actual risks presented by the SBSDs actual exposures.

Record Retention

- **Voice Records**. We approve of the Commission's decision not to mandate voice recording, but the Commission should limit the record retention period for voluntarily recorded voice records to one year, consistent with the CFTC's approach.

- **WORM Storage Challenges**. The Commission should not mandate the use of WORM storage systems for SBSDs and MSBSPs. Furthermore, the Commission should not mandate the use of WORM storage systems more generally, including for broker-dealers who may be dually-registered as SBSDs.

Reporting

- We have a number of serious concerns with proposed Form SBS, some of which are as follows:

    - Proposed Form SBS is not tailored to the unique characteristics of security-based swaps.

    - Proposed Form SBS contains requests for information that are unclear or incomplete.

    - Parts 4 and 5 of proposed Form SBS contain schedules that are treated as part of proposed Form SBS rather than as supplemental to the form.

    - Proposed Form SBS does not adequately address the concerns of U.S. and foreign bank SBSDs and bank MSBSPs.

    - Proposed Form SBS reflects aspects of the SEC Capital and Margin Proposal that should be modified.

- Given these problems with proposed Form SBS, the Commission should enter into a constructive dialogue with interested constituencies with the goal of developing a reporting regime that both is workable for SBSDs and MSBSPs and achieves the Commission's regulatory objectives. At a minimum, the Commission should revise proposed Form SBS to reflect the differences between security-based swap activity and traditional securities activity and address the other concerns raised below.

Cross-Border Considerations

- **Classification and Application of Recordkeeping Requirements.** The Commission should classify requirements relating to daily trading records and confirmations as transaction-level requirements rather than entity-level requirements. Furthermore, the Commission should not apply such transaction-level requirements to transactions of foreign SBSDs (or registered U.S. SBSDs that engage in security-based swap dealing through foreign branches) with non-U.S. persons or foreign branches of U.S. banks.

- **Application of Recordkeeping and Reporting Rules to Foreign Branches**. Registered bank U.S. SBSDs that engage in security-based swap dealing through foreign branches ("**Foreign Branches**") should be permitted to rely on substituted compliance with respect to requirements relating to daily trading records, confirmations, and other recordkeeping requirements that are classified as transaction-level requirements in transactions with non-U.S. persons or other Foreign Branches.

- **Allocation of Duties.** We support the Commission's decision to permit an SBSD to allocate duties to an agent.

- **Foreign Privacy, Secrecy, and Blocking Laws.** The Commission should take into account the issue of foreign jurisdictions' privacy, secrecy, and blocking laws.

- **Other Cross-Border Issues**

    - ***Accounting Standards for Foreign SBSDs and Foreign MSBSPs.*** In advance of making substituted compliance determinations, the Commission should allow Foreign SBSDs to report information on a quarterly basis (in line with U.S. prudentially regulated SBSDs) in accordance with International Financial Reporting Standards ("**IFRS**") rather than U.S. Generally Accepted Accounting Principles ("**U.S. GAAP**").

    - ***Obtaining Information from Associated Persons.*** The Commission should not require foreign SBSDs, foreign MSBSPs, or Foreign Branches to obtain information regarding associated persons who effect or are involved in the effecting transactions solely with respect to their non-U.S. person counterparties.

Phased Implementation of Recordkeeping and Reporting Requirements

- The Commission should phase in the recordkeeping and reporting requirements the later of (i) 12 months after the adoption of the SBS Recordkeeping Proposal or (ii) 12 months after the adoption of the SEC Capital and Margin Proposal. Furthermore, we urge the Commission not to impose implementation deadlines that conflict with the "code freeze" which typically occurs at year-end.

DISCUSSION

I. Harmonization with Other Regulatory Regimes

As the Commission recognizes, different SBSDs and MSBSPs will use different business models to conduct their security-based swap business activity. Some SBSDs and MSBSPs may be dually registered as broker-dealers with the Commission, some SBSDs may be dually registered as OTC derivatives dealers with the Commission, some SBSDs and MSBSPs may be regulated as banks, and other SBSDs and MSBSPs may be stand-alone entities who are neither registered broker-dealers nor regulated as banks. In addition, some SBSDs and MSBSPs may be foreign entities subject to rules and regulation in a foreign jurisdiction ("**foreign SBSDs**" and "**foreign MSBSPs**"). Foreign SBSDs and foreign MSBSPs may be regulated as banks or as broker-dealers by a foreign regulatory authority. Furthermore, as the Commission also recognizes, SBSDs and MSBSPs may be dually registered with the Commodity Futures Trading Commission ("**CFTC**") as swap dealers ("**SDs**"), major swap participants ("**MSPs**"), and/or futures commission merchants ("**FCMs**").[8]

This wide diversity of business models creates the potential for overlapping jurisdiction over registrants, which are often subject to two or three different regulatory regimes with respect to similar activities. SIFMA believes this strongly weighs in favor of aiming for consistency in regulatory approaches, wherever possible, and deferring to comparable and consistent regulatory regimes where appropriate. Accordingly, in the following, we discuss: (i) consistency with CFTC recordkeeping and reporting rules applicable to SDs and MSPs; (ii) deference to recordkeeping and reporting rules established by the prudential regulators; and (iii) deference to foreign rules applicable to foreign SBSDs and foreign MSBSPs.

A. Consistency with CFTC Recordkeeping and Reporting Rules

As noted above, many SBSDs will be dually registered as SDs with the CFTC. As such, they are subject to a comprehensive recordkeeping and reporting regime established by the CFTC for SDs and MSPs.[9] Our members have invested, and continue to invest, an enormous amount of time, money, and effort in complying with the CFTC's rules, including by building systems and technologies to record and report swap activity.

The Dodd-Frank Act requires the SEC to consult and coordinate with the CFTC and the prudential regulators for the purposes of ensuring "regulatory consistency and comparability, to the extent possible."[10] Because the Commission's and the CFTC's approaches to rulemaking

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[8] *See* SEC Capital and Margin Proposal at 25195 n.7.

[9] *See* CFTC, Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20128 (Apr. 3, 2012), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2012-04-03/pdf/2012-5317.pdf.

[10] Section 712(a)(2) of the Dodd-Frank Act.

and implementation timeframes and the content of their rules have not been sufficiently coordinated, market participants have had to develop systems to meet the CFTC's requirements and could be required, in many cases, to develop an entirely new infrastructure to comply with the Commission's security-based swap rules.

SIFMA believes that the Commission should further harmonize its approach to recordkeeping and reporting for dually registered SDs and SBSDs (and dually registered MSPs and MSBSPs). The underlying statutory requirements are virtually identical for SDs/SBSDs and MSPs/MSBSPs and the regulatory goals are the same.[11] By harmonizing the recordkeeping rules for dually registered SDs/SBSDs and MSPs/MSBSPs, the Commission will obtain the benefits the proposal was designed to achieve, while sparing dually registered SBSDs the enormous cost of building out different systems to comply with the SEC recordkeeping and reporting rules, as well as enable dually registered SBSDs to use similar systems for onboarding clients and managing client accounts. If the Commission deems full harmonization with CFTC recordkeeping and reporting rules for SDs and MSPs inappropriate, we still encourage the Commission to reconcile its recordkeeping and reporting rules for SBSDs and MSBSPs with CFTC rules to the maximum extent possible.

- ***Recommendation:*** *The Commission should harmonize its recordkeeping and reporting requirements for SBSDs and MSBSPs with the CFTC's final recordkeeping and reporting rules for SDs and MSPs to the maximum extent possible, with the goal of permitting firms to utilize a single recordkeeping and reporting system for swaps and security-based swaps.*

B. Deference to Recordkeeping and Reporting Rules Established by the Prudential Regulators

As the Commission recognizes, its authority over bank SBSDs and bank MSBSPs is limited.[12] The Commission is not responsible for establishing capital or margin requirements for banks, and its rulemaking authority with respect to recordkeeping requirements is limited to the books and records of activities related to the business of a bank as an SBSD or MSBSP. As such, the proposed requirements applicable to bank SBSDs and bank MSBSPs are narrower in scope than those applicable to stand-alone SBSDs and stand-alone MSBSPs. The Commission also recognizes that, as banks, these registrants are subject to existing recordkeeping and reporting requirements administered by the prudential regulators; therefore, to avoid potentially duplicative or conflicting requirements, the Commission has proposed fewer recordkeeping and reporting requirements for bank SBSDs and bank MSBSPs.

Thus, the Commission's interest in bank SBSDs and bank MSBSPs is significantly different from its interest in SBSDs and MSBSPs that are broker-dealers or that are stand-alone entities. Accordingly, SIFMA believes that the Commission should craft a much more tailored

[11] *See* Sections 4s(f) and (g) of the CEA, as added by Section 731 of the Dodd-Frank Act, and Sections 15F(f) and (g) of the Exchange Act, as added by Section 764(a) of the Dodd-Frank Act.

[12] *See* SEC Recordkeeping Proposal at 25197.

recordkeeping and reporting regime for bank SBSDs and bank MSBSPs. Such an approach should narrowly focus on the specific customer protection concerns that the Commission has for this category of registrant and avoid the imposition of duplicative or conflicting recordkeeping and reporting requirements on bank SBSDs and bank MSBSPs.

In addition, given the Commission's narrow regulatory interest in bank SBSDs and bank MSBSPs, SIFMA believes that the Commission should defer to the existing recordkeeping and reporting requirements administered by the prudential regulators. Such rules should be supplemented with additional requirements only to the extent that such additional obligations are necessary for the Commission to fulfill its regulatory oversight of bank SBSDs and bank MSBSPs.

Regardless of the approach the Commission ultimately decides to adopt, SIFMA believes that it is critical that the Commission clarify the meaning of "activities related to the business" of a bank as an SBSD or MSBSP, which appears a number of times in the rulemaking as a way of cabining the proposed requirements with respect to banks. However, banks do not operate their security-based swap activity as a walled-off unit within the bank, whose activities would be easy to circumscribe. For example, because hedging activity often occurs across business units, often hedging risk rather than specific product types, the question arises whether such activity would be considered by the Commission as part of the business of a bank as an SBSD or MSBSP if it were conducted, in part, for the purpose of hedging security-based swap activity. SIFMA's view is that the business of a bank as an SBSD or MSBSP should be interpreted narrowly, consistent with the limited regulatory interest that the Commission has in bank SBSDs and bank MSBSPs.

- ***Recommendation:*** *The Commission should permit bank SBSDs and bank MSBSPs to satisfy the Commission's recordkeeping and reporting requirements by complying with recordkeeping and reporting rules established by their prudential regulator. These rules should be supplemented with additional requirements only to the extent that such additional obligations are necessary for the Commission to fulfill its limited oversight of the security-based swap activities of bank SBSDs and bank MSBSPs. Furthermore, the Commission should interpret the business of a bank as an SBSD or MSBSP narrowly, consistent with the Commission's limited regulatory interest in bank SBSDs and bank MSBSPs.*

C. Deference to Recordkeeping and Reporting Rules Established by Foreign Regulators[13]

The Commission, the CFTC, and the prudential regulators are required to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps, security-based swaps, swap entities, and security-based swap entities . . . in order to promote effective and consistent global regulation of swaps and security-based swaps."[14] The Commission has proposed a framework

[13] In Section VI.B below, we discuss the application of recordkeeping and reporting rules to foreign branches of U.S. banks.

[14] Section 752(a) of the Dodd-Frank Act.

that would allow a foreign SBSD to satisfy the requirements of Section 15F of the Exchange Act, and the rules and regulations thereunder, by complying with foreign law that the Commission has deemed comparable with the relevant SBSD regulations.[15] The Commission proposes to make such comparability determinations using an outcomes-based approach. Under such an approach, substituted compliance determinations would focus on the similarities in regulatory objectives, rather than requiring that the foreign jurisdiction's rules be identical.

SIFMA supports the Commission's proposed approach. We believe that it is consistent with the goal of international comity and is preferable to a rule-by rule comparison.

We note, however, that, while it is likely that most jurisdictions will have generally comparable recordkeeping and reporting requirements, as such requirements are foundational to the oversight of registrants in most jurisdictions, it still may be the case that some jurisdictions are in the process of adopting new rules, or amendments to existing rules, to address the specific characteristics of swap agreements. Accordingly, the deference to local regulation available under the Commission's proposed approach to substituted compliance may be significantly delayed for foreign SBSDs that intend to apply for substituted compliance but that may operate in jurisdictions where final rules will still be in the process of being adopted, or not have come into effect, when the Commission's recordkeeping requirements become effective. Similarly, the Commission may not have had the opportunity to make a comparability determination by the relevant time. In those circumstances, foreign SBSDs face the prospect of being subject to U.S. regulations for the period of time until the finalization of home-jurisdiction regulations, plus the length of time it takes for the Commission to make an accompanying comparability determination.

To address this issue, we believe that foreign SBSDs should be provided relief from compliance with the cross-border application of the SEC's substantive requirements, including the proposed recordkeeping and reporting requirements, until the Commission has had the opportunity to provide substituted compliance determinations. We believe that this is preferable to requiring foreign SBSDs to build the technological, operational, and compliance systems required to comply with U.S. law for a short, interim period.

- ***Recommendation:*** *The Commission should permit a foreign SBSD or foreign MSBSP to satisfy its recordkeeping and reporting requirements by complying with recordkeeping and reporting rules established by its foreign regulator, provided such rules are comparable to Commission rules. Furthermore, the Commission should delay the cross-border application of its substantive requirements with respect to foreign SBSD and foreign MSBSP, including the proposed recordkeeping and reporting requirements, until the finalization of home-jurisdiction regulations, plus the length of time it takes for the Commission to make an accompanying comparability determination.*

[15] *See* SEC, Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Release No. 34-69490 (May 1, 2013), 78 Fed. Reg. 30968, 31085-92 (May 23, 2013) ("**SEC Cross-Border Proposal**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-10835.pdf.

II. Preliminary Considerations

In the following, we first discuss certain preliminary considerations relating to the concept of a "security-based swap account" and the permissibility of allocation of duties to agents, before going on in the next section to discuss the proposal in more detail.

A. Security-Based Swap Accounts

Because of its centrality in the SEC Recordkeeping Proposal, we discuss the concept of a "security-based swap account" before discussing the proposal in more detail. As explained below, we are concerned that the Commission may be construing a "security-based swap account" too rigidly and not appropriately accounting for the unique characteristics of security-based swaps. Among other things, we are particularly concerned that this may make it even more difficult for the Commission to accommodate portfolio margining and cross-margining.

1. General Considerations

Under existing rules, broker-dealers carry customer securities positions in a cash, margin, or good faith account. In proposed rulemaking under Title VII of the Dodd-Frank Act, including proposed rules relating to capital, margin, and segregation requirements, the Commission has proposed that SBSDs would need to treat security-based swap accounts separately from other securities accounts.[16]

SIFMA understands that security-based swaps would be subject, in some cases, to different requirements than apply to existing securities accounts. For example, the SEC Capital and Margin Proposal would require SBSDs to perform separate possession or control and reserve account computations for security-based swap positions and securities accounts, which is intended to keep separate the customer property related to security-based swaps from customer property related to other securities activities, including property of retail securities customers.[17]

Nonetheless, SIFMA believes that "security-based swap account" lacks clarity and is concerned that the Commission may be conceiving of a security-based swap account too closely along the lines of a traditional securities account, without fully appreciating the important differences between security-based swaps and most securities.

Unlike most securities, a security-based swap is a transaction that gives rise to ongoing obligations between counterparties during the life of the security-based swap. As a result, each party to the transaction is generally obligated to perform under the security-based swap in accordance with its terms until the transaction expires or is terminated. Thus, in a security-based swap, parties generally have ongoing obligations toward each other. This ongoing contractual relationship between parties distinguishes a security-based swap from most securities and is reflected in the different ways in which security-based swaps and most securities are treated for recordkeeping purposes. Most securities, such as debt and equity securities, are carried for a

[16] *See* SEC Capital and Margin Proposal; SEC Recordkeeping Proposal.

[17] *See* SEC Capital and Margin Proposal at 70277.

customer by a broker-dealer in its traditional role as an intermediary. This is reflected in how they are recorded on a broker-dealer's books. In a security-based swap, on the other hand, an SBSD or MSBSP will be entering into an ongoing contractual relationship with a counterparty. As such, the way in which it records the transaction on its books will be different from how it records most securities positions.

Because of the differences between security-based swaps and most securities, SIFMA believes that the Commission's recordkeeping and reporting rules should not be overly prescriptive, but should be flexible enough to permit SBSDs and MSBSPs to use existing systems to record the information that the Commission needs regarding security-based swap transactions to achieve its regulatory goals. In particular, we think the Commission should avoid using terms and concepts that are more appropriate for debt and equity securities, but which are not really applicable to security-based swaps – for example, terms like "stock records," "longs and shorts," and "purchase and sale."[18]

In this regard, we note that the CFTC has established reporting and recordkeeping requirements and daily trading records requirements for SDs and MSPs that require full and complete swap transaction information to be recorded and maintained, without prescribing a detailed format for such recordkeeping. This provides firms with flexibility in how they maintain a "swap account" under CFTC rules.

- ***Recommendation:*** *The Commission should allow flexibility in how a "security-based swap account" is understood and operationalized to enable SBSDs and MSBSPs to have flexibility in how they keep and maintain required records relating to security-based swaps. Furthermore, the Commission should not define or interpret a "security-based swap account" in a way that would be inconsistent with the CFTC's concept of a "swap account."*

2. Portfolio Margining and Cross-Margining

It is important that the proposal not define a "security-based swap account" in such a way that an SBSD or MSBSP would be prevented from holding other types of securities in such an

[18] In recognition of the difference between security-based swaps and most securities, Section 761(a)(3) of the Dodd-Frank Act amends the definitions of "buy" and "purchase" in Section 3(a)(13) of the Exchange Act to provide: "For security-based swaps, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require." Section 761(a)(4) of the Dodd-Frank Act amends the definitions of "sale" and "sell" in Section 3(a)(13) of the Exchange Act to provide: "For security-based swaps, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require."

These amendments, in some ways, create more confusion. For example, normally when there is a purchase there is also a sale, and a seller and a buyer. When parties execute swaps, however, there may be a purchase and a sale under these amended definitions, but it is not possible to identify a buyer or seller – or maybe both are buyers when the swap is executed and sellers when the swap is terminated?

account. Not only may this be appropriate for securities posted as collateral for security-based swaps, but it is particularly important in the case of portfolio margining and cross-margining. In this regard, we note that the Dodd-Frank Act amended both the Exchange Act and CEA to give the Commission and the CFTC additional tools to foster portfolio margining with respect to securities held in a portfolio margining account carried as a futures account.[19]

As we have previously commented to the Commission, calculating margin requirements on a portfolio basis offers many benefits, including greater efficiencies as a result of the recognition of off-setting positions and better alignment of costs and overall portfolio risk.[20] Portfolio margining alleviates excessive margin calls, improves cash flows and liquidity and reduces the impact of individual position volatility. The Commission has made great progress in the area of portfolio margining. However, there is more work to be done to provide market participants with the ability to use portfolio margining for all risk-offsetting products.

We support the Commission's efforts to date to allow parties to use portfolio margining. Specifically, we support the proposal to allow omnibus segregation and portfolio margining of initial margin held for cleared and uncleared SBS. We also commend the Commission's recent order permitting the commingling and portfolio margining of cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the CEA.[21] This is a valuable step in overcoming the gap between functionally equivalent products that are subject to different regulatory and insolvency regimes.

There are, however, other risk-offsetting products that should be included in the Commission's portfolio margining regime. For example, market participants offset the risk of both cleared and uncleared CDS that are security-based swaps with cleared and uncleared index CDS that are swaps. SBSDs that use internal models to calculate initial margin for these products have the capabilities to calibrate margin on a portfolio basis. However, regulatory and legal barriers prevent them from doing so and obtaining the benefits of portfolio margining.

In particular, we acknowledge that there are challenges to the comprehensive portfolio margining of SEC- and CFTC-regulated products as a result of different insolvency and customer protection regimes. For example, net equity claims of securities customers of broker-dealers are eligible for up to $500,000 of protection from the fund maintained by the Securities Investor Protection Corporation, but no similar fund is maintained to protect customers of SDs and FCMs.

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[19] *See* Section 15(c)(3) of the Exchange Act, as added by Section 713(a) of the Dodd-Frank Act, and Sections 4d and 20 of the CEA, as added by Sections 713(b) and (c) of the Dodd-Frank Act.

[20] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal at A2-5 – A2-10; *see also* SIFMA Comment Letter on Margin for Uncleared Swaps at 14-15.

[21] *See* SEC, Exemptive Order and Request for Comment, Order Granting Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-Based Swaps, Release No. 34-68433 (Dec. 14, 2012), 77 Fed. Reg. 75211 (Dec. 19, 2012), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2012-12-19/pdf/2012-30553.pdf.

Notwithstanding these challenges, we believe portfolio margining can be achieved. In particular, the Commission and the CFTC have repeatedly recognized, through cross-margining orders, portfolio margining arrangements under which a securities counterparty subordinates itself to securities customers and has its positions carried in a commodities account (*i.e.*, a futures or, more recently, cleared swap account). As noted above, the Dodd-Frank Act also contemplates portfolio margining of futures positions in a securities account, and the Commission's recent cross-margining order, noted above, contemplates portfolio margining of cleared swap positions in a securities account.

In addition, market participants have developed arrangements for cross-margining cleared and uncleared derivatives. Under these arrangements, the total initial margin would be calculated based on the risks of both cleared and uncleared derivative portfolios. Although this will result in a lower total initial margin requirement, it will more accurately reflect the risk of default on a portfolio basis. The clearing organization would receive the full amount of initial margin to which it is entitled and the uncleared derivative counterparty would receive the remainder. In an event of default, the clearing organization and clearing broker would be paid in full with the initial margin they hold and any excess margin would be available (subject to the prior claims of the clearing organization, clearing brokers and customers) to satisfy the claim of the uncleared derivative counterparty. These arrangements have been in place for years to establish cross-margining between futures contracts and OTC derivatives, and have proven to be an effective mechanism for calibrating margin requirements to reflect accurately the overall risk presented by a counterparty's portfolio. Similar arrangements also are commonly used in other areas, such as in cross-margin derivatives and correlated cash positions (margin loans and short positions in prime brokerage arrangements), listed options, repo and/or securities lending positions.[22]

To the extent that portfolio margining involves holding security-based swaps in an account that is not a security-based swap account, SIFMA believes that the Commission should make it clear that security-based swaps do not necessarily have to be maintained in a security-based swap account and that records can be maintained in the form appropriate to such other type of account.

- ***Recommendation:*** *The Commission should not define a security-based swap account in such a way that an SBSD or MSBSP would be prevented from holding other types of securities in a security-based swap account. Furthermore, the Commission should build*

[22] Elsewhere, SIFMA has recommended: "We believe the [U.S.] Agencies should take whatever steps are available to them to permit portfolio margining to the fullest extent consistent with the BCBS-IOSCO Framework. In particular, the Prudential Regulators should permit a bank registrant voluntarily to include non-centrally cleared non-swap/non-security-based swap derivatives within a portfolio of non-centrally cleared swaps and security-based swaps, provided that the registrant otherwise complies with all the requirements applicable to it under the rules in connection with that portfolio, including the calculation of margin amounts, recognition of netting effects and segregation of collateral. With respect to the CFTC and the SEC, SIFMA continues to support the recommendations it has previously provided regarding steps that could be taken to facilitate portfolio margining across different categories of non-centrally cleared derivatives." SIFMA Comment Letter on Margin for Uncleared Swaps at 15.

on existing precedent by working with the CFTC to facilitate the expansion of portfolio- and cross-margining arrangements.

B. Allocation of Duties

As discussed below, the SEC Cross-Border Proposal allows an SBSD to allocate Title VII duties to an agent, provided that the SBSD ultimately remains responsible for compliance with the applicable requirements.[23] This provides firms the flexibility necessary for the broad range of business relationships that exist in the security-based swap markets. However, many U.S. SBSDs that are not themselves fully regulated broker-dealers will have affiliated fully regulated broker-dealers who act as agents. Front office personnel, for example, who trade security-based swaps also may be transacting in securities and will accordingly be employees, or otherwise associated persons, of affiliated fully regulated broker-dealers. Therefore, we believe that the Commission should permit, more generally, any SBSD (both U.S. and foreign) to allocate its Title VII obligations, including its obligations with respect to books and records, to an agent, provided that the SBSD ultimately would remain responsible for compliance with the applicable requirements. In this regard, we note that the Commission explicitly permits an OTC derivatives dealer's books and records to be maintained by an affiliated fully regulated broker-dealer.

- ***Recommendation:*** *The Commission should permit both U.S. and foreign SBSDs to allocate their Title VII obligations, including their obligations with respect to books and records, to their agent, provided that the SBSD ultimately remains responsible for compliance with the applicable requirements.*

III. Recordkeeping

The Commission's proposed recordkeeping and reporting rules are designed to provide transparency into the business activities of SBSDs and MSBSPs and assist the Commission in reviewing and monitoring compliance with the proposed capital, margin, and segregation requirements applicable to SBSDs and MSBSPs. The proposed rules also are designed to require information that would facilitate a comprehensive and accurate trade reconstruction for each security-based swap transaction. The Commission attempts to achieve these goals by proposing very prescriptive recordkeeping and reporting rules for SBSDs and MSBSPs that are modeled on existing rules applicable to broker-dealers, in particular Rules 17a-3 and 17a-4 under the Exchange Act. However, Rules 17a-3 and 17a-4 were not designed to address the activities of broker-dealers in security-based swaps but in ordinary securities, such as debt and equity securities. As such, they are, in many cases, ill-suited to capturing the details of security-based swap transactions.

Accordingly, in general, we recommend that the Commission adopt a less prescriptive approach to specifying the recordkeeping and reporting elements required for security-based swaps to ensure that firms have the flexibility to implement recordkeeping systems that are tailored to the unique characteristics of security-based swaps. The Commission's approach also

[23] *See* Section VI.C, *infra*.

should be compatible with the recordkeeping and reporting systems that SDs and MSPs have already developed to comply with the CFTC's recordkeeping and reporting requirements, to the extent possible. This would enable firms to comply with the SEC recordkeeping and reporting requirements by using the procedures and systems developed and implemented for compliance with the CFTC requirements. In addition, this would lower firms' compliance costs, while still enabling the Commission to achieve the goals of its reporting and recordkeeping regime.

In the following, we discuss each of the recordkeeping requirements in the proposed rule in detail.

A. Transaction Information

1. Trade Blotters

The proposal relating to trade blotters is modeled on paragraph (a)(1) of existing Rule 17a–3, which requires broker-dealers to make and keep current trade blotters (or other records of original entry) containing an itemized daily record of all transactions in securities, all receipts and deliveries of securities, all receipts and disbursements of cash, and all other debits and credits. The Commission is proposing an amendment to require that the blotters specifically account for security-based swaps, and proposing to include parallel blotter requirements in paragraphs (a)(1) and (b)(1) of proposed Rule 18a–5 that are modeled on paragraph (a)(1) of Rule 17a–3, as proposed to be amended. The Commission does this by proposing to clarify that the reference to "securities" includes security-based swaps and by requiring that the records include certain additional information regarding security-based swaps in order to document the attributes of security-based swaps. Under the proposal, the records would show the contract price of the security-based swap, and include for each purchase and sale, the following additional information: (1) The type of security-based swap; (2) the reference security, index, or obligor; (3) the date and time of execution; (4) the effective date; (5) the termination or maturity date; (6) the notional amount; (7) the unique transaction identifier; and (8) the unique counterparty identifier.

As noted above, security-based swaps are different from most types of securities transactions and, therefore, terminology that is appropriate for ordinary securities is not necessarily correct for security-based swaps – *e.g.*, "longs and shorts" and "purchases and sales." Because security-based swaps are not securities that are carried in a customer account as most securities (*e.g.*, debt and equity securities) are, but rather contractual relationships between counterparties, the concept of "trade blotter" must be expanded to accommodate these bilateral arrangements.

To some extent, the Commission has attempted to do this by specifying additional information that must be recorded regarding security-based swap transactions. However, because this information and other contractual terms regarding security-based swap transactions may not necessarily be gathered together in one place called a "trade blotter," firms should have flexibility in the manner in which they record security-based swap transactions, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be akin to a "trade blotter." Such an approach would be

consistent with CFTC requirements and give firms flexibility to maintain information in a way that is consistent with the nature of swap transactions.

In addition, with respect to the requirement to make a record of the "unique counterparty identifier" on the trade blotter, we note that SIFMA, its global affiliate, the Global Financial Markets Association, and others globally, continue work to promote use of the LEI as an important foundation tool for better risk management and financial stability.[24] With the recent establishment of the Global LEI Foundation ("**GLEIF**") and the appointment of the GLEIF Board, we believe the LEI is now on a stable course for continued global adoption. Having a uniform, global legal entity identifier will help regulators, supervisors, researchers, and firms to better measure and monitor systemic risk, more effectively measure and manage counterparty exposure, and improve operational efficiencies. Progress toward the development of the GLEIS during the past several years has been good. Globally, there are now 17 pre-Local Operating Utilities ("**LOUs**") which issue and maintain LEIs, while nearly 300,000 LEIs, in more than 160 countries, have been issued to date. Creating a single LEI standard across regulators will allow for more effective regulatory oversight and be more efficient for firms. Accordingly, we believe that the Commission should make the use of LEIs mandatory.[25]

Although we believe strongly in the use of globally harmonized LEIs, some firms may use different counterparty identifiers for internal purposes. As long as such firms are able to translate their internal counterparty identifiers into the standard LEI convention[26] (both for their own regulatory reporting purposes and for regulatory examination purposes), they should be able to continue to use their internal counterparty identifiers on the trade blotter and other internal firm records.

- ***Recommendation:*** *The Commission should make the use of LEIs mandatory, although it should permit firms to use different counterparty identifiers for internal firm purposes as long as they are able to translate their internal counterparty identifiers into the standard LEI convention. Furthermore, the Commission should, as appropriate, provide SBSDs and MSBSPs flexibility in the manner in which they record security-based swap*

[24] *See, e.g.,* "Requirements for a Global Legal Entity Identifier (LEI) Solution" (May 2011), *available at:* http://www.gfma.org/uploadedfiles/initiatives/legal_entity_identifier_%28lei%29/requirementsforagloballeisolution.pdf.

[25] Of course, SBSDs and MSBSPs may not have LEIs for all of their counterparties. We recommend that the SEC require SBSDs and MSBSPs to follow the CFTC's three-step guidance regarding the use of LEIs. Specifically, SBSDs and MSBSPs should (i) contact each of their security-based swap counterparties to determine whether the counterparty has an LEI, (ii) obtain the counterparty's LEI if the LEI has already been issued, and (iii) if the counterparty does not yet have an LEI and the SBSD or MSBSP knows the counterparty has an obligation to obtain one, remind the counterparty of that obligation. See Division of Market Oversight and Office of Data and Technology Advisory Regarding Upcoming Legal Entity Identifier Deadline (Mar. 15, 2013), *available at:* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/dmo_odtadvisory.pdf. An SBSD or MSBSP that follows this process for counterparties who have not provided an LEI should be able to use some alternative identifier for the those counterparties until they provide an LEI.

[26] Where the firm has an LEI for the counterparty. *See* note 25, *supra*.

transactions, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be a record of original entry.

2. Memoranda of Brokerage Orders

The proposal relating to memoranda of brokerage orders is modeled on paragraph (a)(6) of existing Rule 17a–3, which requires broker-dealers to make and keep current a memorandum of each brokerage order, and of any other instruction given or received for the purchase or sale of a security (an "order ticket"). The Commission is proposing to amend these requirements to require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to make and keep current a memorandum of each brokerage order given or received for the purchase or sale of a security-based swap. The Commission is not proposing to include a parallel provision applicable to stand-alone SBSDs and stand-alone MSBSPs because these registrants would not be permitted to engage in the business of effecting brokerage orders in security-based swaps without registering as a broker-dealer or a bank.[27] The Commission is, however, including a parallel memorandum requirements in paragraph (b) of proposed Rule 18a–5 applicable to bank SBSDs and bank MSBSPs proposed Rule 18a–5 that is modeled on paragraph (a)(6) of Rule 17a–3, as proposed to be amended. Bank SBSDs and bank MSBSPs would only be required to document key terms of brokerage orders with respect to security-based swaps.

SIFMA generally supports the proposal, but asks the Commission to confirm that the order ticket requirement only applies when there are in fact orders received for execution (*e.g.*, where the orders are potentially executed on a security-based swap execution facility), and not where there is a negotiation that results in a transaction without any executable order or other instruction given.[28] Similarly, SIFMA also asks the Commission to confirm no order ticket

[27] As noted above, the Commission should explicitly note that references to stand-alone SBSDs explicitly include stand-alone SBSDs that are registered as OTC derivatives dealers. In this letter, references to stand-alone SBSDs are intended to apply to OTC derivatives dealers that are dually registered as SBSDs (and such entities are also approved to use internal models).

[28] These negotiations often take place over the telephone, but can also make use of electronic systems, or even security-based swap execution facilities. For example, a market participant may submit to one or more SBSDs a request for quotation ("**RFQ**") for a specific security-based swap and receive back an offer from those SBSDs to enter the swap on specified terms. In that case, the market participant's acceptance of the offer from a SBSD will create a security-based swap transaction between the market participant and the SBSD without the market participant ever sending an order to the SBSD.

In other cases, a transaction negotiation will result in an agreement on conditional terms of a transaction, *e.g.*, a transaction where one or more terms will be determined by reference to a price at which the SBSD is able to execute a hedge transaction (within agreed price, time and/or method parameters) and/or by reference to the size of the hedge transaction that the SBSD is able to execute (within the agreed parameters). In these cases, we believe the SBSD should be required to record the negotiated transaction, after the conditional terms have been determined, in its trade blotter, but should not be required to create an order ticket since no executable order or other instruction is given. (To the extent the SBSD itself gives orders for the execution of a hedge transaction, a proprietary order ticket would need to be created for those orders.)

needs to be created by the broker-dealer or its affiliated SBSD when a registered broker-dealer acts as an agent in connection with negotiated transactions between an affiliated SBSD and its customers without any executable order being received.[29] Such an approach would be consistent with CFTC requirements and the purpose of an order ticket.

See also the discussion in Section VI.C below regarding allocation of duties in the cross-border context.

- ***Recommendation:*** *The Commission should confirm that the order ticket requirement only applies when there are in fact orders submitted for execution.*

3. Memoranda of Proprietary Trades and Orders

The proposal relating to proprietary trade and order tickets is modeled on paragraph (a)(7) of Rule 17a–3, which requires broker-dealers to make and keep current a memorandum of each purchase and sale for the account of the broker-dealer ("trade ticket") and where the purchase or sale is with a customer other than a broker-dealer, a memorandum of each order received ("order ticket"). The Commission is proposing to amend these requirements to require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to make and keep current a memorandum of the terms of security-based swap transactions when they are acting as a dealer or otherwise trading for their own account and, where the transaction is with someone other than a broker-dealer, a memorandum of each order received. The Commission also is proposing to include parallel memorandum requirements in paragraphs (a) and (b) of proposed Rule 18a–5 applicable to stand-alone SBSDs and standalone MSBSPs and, solely with respect to security-based swaps, bank SBSDs and bank MSBSPs.

The trade ticket would need to include certain information regarding the purchase or sale of a security-based swap for the account of the broker-dealer that is similar to the information currently required under paragraph (a)(7) of Rule 17a–3. In addition, to account for the attributes of security-based swaps, the trade ticket would need to include: (1) The type of security-based swap; (2) the reference security, index, or obligor; (3) the date and time of execution; (4) the effective date; (5) the termination or maturity date; (6) the notional amount; (7) the unique transaction identifier; and (8) the unique counterparty identifier.

While SIFMA generally supports the trade ticket proposal, we would like the Commission to confirm the following with respect to order tickets in the context of proprietary trades:

- Order tickets are not required when the transactions are negotiated transactions; and

[29] In the cross-border context, a U.S. broker-dealer acting as agent for an affiliated SBSD or MSBSP in the execution of negotiated security-based swap transactions of the affiliate and its counterparty should not be required to maintain an account for the affiliated SBSD or MSBSP or its counterparties (or record the agented transactions in such an account or on its "stock record").

- Although a U.S. broker-dealer will need to create and maintain trade tickets to the extent it participates in the execution of transactions as agent for an affiliated SBSD or MSBSP, the U.S. broker-dealer and its affiliated SBSD or MSBSP should not have to duplicate these records (*e.g.*, the affiliated SBSD could rely on records maintained by the registered broker-dealer).

➢ ***Recommendation:*** *The Commission should provide the confirmations requested above.*

4. Confirmations

The proposal relating to confirmations is modeled on paragraph (a)(8) of Rule 17a–3, which requires broker-dealers to make and keep current copies of confirmations of purchases and sales of securities. The Commission is proposing to require broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, to make and keep current copies of the security-based swap trade acknowledgments and verifications made pursuant to proposed Rule 15Fi–1 under the Exchange Act.[30] Paragraph (a)(6) of proposed Rule 18a–5 would require stand-alone SBSDs and stand-alone MSBSPs to make and keep current copies of confirmations of all purchases or sales of securities (including security-based swaps). Paragraph (b)(6) of proposed Rule 18a-5 would require bank SBSDs and bank MSBSPs to make and keep current copies of all confirmations of purchases and sales of all (i) security-based swaps and (ii) securities that are not security-based swaps but only if "related to the business" of an SBSD or MSBSP.

Although SIFMA generally supports the Commission's proposal with respect to broker-dealer SBSDs/MSBSPs and stand-alone SBSDs/MSBSPs, we urge the Commission to harmonize its trade acknowledgement and verification proposal with the final CFTC rules relating to trade acknowledgement.[31] In particular, we urge the Commission to reconsider the requirement that SBSDs and MSBPs promptly verify the accuracy of, or dispute with its counterparty, the terms of a trade acknowledgment that it receives, as current market practices do not universally follow an acknowledgement/verification model, particularly with respect to "mid-life" trade events.[32] Instead, we encourage the Commission to enter into a constructive dialogue with interested constituencies to establish best practices for trade verification. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.

In addition, we are concerned that, with respect to bank SBSDs and bank MSBSPs, it is not clear when purchases and sales of securities are "related to the business" of a bank as an SBSD or MSBSP. For example, does the Commission intend to include hedging transactions entered into in connection with a security-based swap? This may be difficult to identify because financial entities typically hedge exposures on an aggregate basis, without necessarily identifying

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[30] *See* SEC Trade Acknowledgment Proposal.

[31] *See* CFTC, Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 Fed. Reg. 55904 (Sept. 11, 2012), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2012-09-11/pdf/2012-21414.pdf.

[32] *See, e.g.*, ISDA comment letter on SEC Trade Acknowledgement Proposal (Feb. 22, 2011), *available at:* http://www.sec.gov/comments/s7-03-11/s70311-4.pdf.

a one-to-one relationship between the hedge and an underlying instrument such as a security-based swap. In addition, it is unclear what regulatory purposes would be served by the Commission having this information. In short, we are concerned that bank SBSDs and bank MSBSPs will have a difficult time identifying transactions that relate to their business as an SBSD or MSBSP and that it will impose unreasonable burdens without an apparent offsetting regulatory benefit.

- ***Recommendation:*** *The Commission should harmonize its trade acknowledgement and verification proposal with the CFTC rules relating to trade acknowledgment. Furthermore, the Commission should not require a bank SBSD or bank MSBSP to make and keep current copies of all confirmations of purchases and sales of securities (other than security-based swaps). In the alternative, the Commission should narrowly interpret when securities transactions are "related to the business" of a bank as an SBSD or MSBSP.*

5. Unverified Security-based Swap Transactions

To promote compliance with proposed Rule 15Fi–1 and the risk management practices of broker-dealers, SBSDs, and MSBSPs, the Commission is proposing to amend Rule 17a–3 to add a requirement to make a record of each security-based swap trade acknowledgment that is not verified within five business days of execution and to include parallel provisions in paragraphs (a) and (b) of proposed Rule 18a–5. Such requirements would apply to all types of SBSDs and MSBSPs.

SIFMA asks the Commission to consider our comment regarding the confirmation requirement above. As indicated in the preceding section, SIFMA urges the Commission to reconsider its security-based swap verification requirements. If verifications are required, we also disagree with this rigid five-day timeframe for obtaining them and instead recommend that the Commission enter into a constructive dialogue with market participants to establish best practices for trade verification.

- ***Recommendation:*** *The Commission should not establish a rigid five-day timeframe for obtaining verifications and instead should enter into a constructive dialogue with interested constituencies to establish best practices for trade verification. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.*

B. Firm Records

1. Option Positions

The proposal relating to option positions is modeled on paragraph (a)(10) of Rule 17a–3, which requires broker-dealers to make and keep current a record of all option positions. The Commission is not proposing to amend paragraph (a)(10) of Rule 17a–3 to account for security-based swaps. However, in order to facilitate the monitoring of the financial condition of stand-alone SBSDs and stand-alone MSBSPs, the Commission is proposing to include a parallel provision in paragraph (a)(8) of proposed Rule 18a–5 applicable to stand-alone SBSDs and

stand-alone MSBSP. As such, these registrants would be required to make and keep current the same type of records broker-dealers must keep: A record of all puts, calls, spreads, straddles, and other options in which the stand-alone SBSD or stand-alone MSBSP has any direct or indirect interest or which the stand-alone SBSD or stand-alone MSBSP has granted or guaranteed, containing, at a minimum, an identification of the security and the number of units involved. This requirement would not be applicable to bank SBSDs or bank MSBPs.

- ***Recommendation:*** *SIFMA supports the Commission's proposal relating to recordkeeping for option positions, including its decision not to impose option positions recordkeeping requirements on bank SBSDs and bank MSBPs.*

2. General Ledger

The proposal relating to the general ledger is modeled on paragraph (a)(2) of Rule 17a–3, which requires broker-dealers to make and keep current ledgers (or other records) reflecting all assets and liabilities, income and expense, and capital accounts. These records reflect the overall financial condition of the broker-dealer and in the Commission's view can incorporate security-based swap activities without the need for a clarifying amendment. The Commission is proposing to include a parallel provision in paragraph (a)(2) of proposed Rule 18a–5 that mirrors paragraph (a)(2) of Rule 17a–3 requiring stand-alone SBSDs and stand-alone MSBSPs to make and keep current the same types of general ledgers. This requirement would not be applicable to bank SBSDs or bank MSBPs.

It is important that firms have flexibility to keep general ledgers in various formats so long as all required information is kept. Such an approach would be consistent with CFTC requirements and give firms flexibility to maintain information in a way that is consistent with the nature of their security-based swap business, thus lowering costs while still achieving the Commission's regulatory objectives.

- ***Recommendation:*** *The Commission should provide firms flexibility to keep general ledgers in various formats without mandating a particular format, so long as all required information is kept and accessible to the Commission.*

3. Stock Record

The proposal relating to a stock record is modeled on paragraph (a)(5) of Rule 17a–3, which requires broker-dealers to make and keep current a securities record (also referred to as a "stock record"). As the Commission notes, this is a record of the broker-dealer's custody and movement of securities. The "long" side of the record accounts for the broker-dealer's responsibility as a custodian of securities and shows, for example, the securities the firm has received from customers and securities owned by the broker-dealer. The "short" side of the record shows where the securities are located such as at a securities depository.

The Commission is proposing to amend paragraph (a)(5) of Rule 17a–3 to require that the securities record specifically account for security-based swaps, and to include parallel securities record requirements in paragraphs (a) and (b) of proposed Rule 18a–5 that are modeled on

paragraph (a)(5) of Rule 17a-3, as proposed to be amended. Specifically, this would require a broker-dealer, including a broker-dealer SBSD and broker-dealer MSBSP, to make and keep current a securities record or ledger reflecting separately for each security-based swap: (1) The reference security, index, or obligor; (2) the unique transaction identifier; (3) the unique counterparty identifier; (4) whether it is a "long" or "short" position in the security-based swap; (5) whether the security-based swap is cleared or not cleared; and (6) if cleared, identification of the clearing agency where the security-based swap is cleared. Stand-alone SBSDs and stand-alone MSBSPs would be required to make and keep current the same type of securities record, while bank SBSDs and bank MSBSPs would be required to make and keep current a securities record of the firm's securities positions but only with respect to positions "related to the business" of a bank as an SBSD or MSBSP.

For the reasons given above, firms do not normally create a "stock record" for security-based swaps. Firms also do not identify security-based swaps as being "long" or "short" in the way that they do with respect to most securities. To reflect the particular characteristics of security-based swaps, firms should have flexibility in the manner in which they create records for security-based swap transactions, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be akin to a "stock record." Such an approach would be consistent with CFTC requirements and give firms flexibility to maintain information in a way that is consistent with the nature of security-based swap transactions.

Flexibility is particularly important in connection with tracking collateral received and pledged on the stock record. Building a collateral management system is a complex and time-consuming exercise. We therefore urge the Commission to allow sufficient time for firms to build out the necessary systems. In addition, it is important for bank SBSDs and bank MSBSPs to have the flexibility to use the existing recordkeeping systems they are required to establish by their prudential regulators.

- ***Recommendation:*** *The Commission should provide SBSDs and MSBSPs flexibility in the manner in which they create records for security-based swap transactions and not mandate a detailed specified format, particularly with respect to tracking collateral received and pledged, provided that all required information is recorded and retained and can be pulled together upon request to create something that recognizably would be a record of the firm's security-based swap transactions. Furthermore, the Commission should allow sufficient time for firms to build out the necessary collateral systems.*

C. Accounts

1. Ledger Accounts

The proposal relating to ledger accounts is modeled on paragraph (a)(3) of Rule 17a–3, which requires broker-dealers to make and keep current certain ledger accounts (or other records) relating to securities and commodities transactions in customer and non-customer cash and margin accounts. The Commission is proposing to amend paragraph (a)(3) of Rule 17a–3 to require that the ledgers (or other records) specifically account for security-based swaps, and to

include parallel ledger requirements in paragraphs (a) and (b) of proposed Rule 18a–5 that are modeled on paragraph (a)(3) of Rule 17a–3, as proposed to be amended. In particular, the proposal would include a requirement that broker-dealers, including broker-dealer SBSDs and broker-dealer MSBSPs, make and keep current ledger accounts (or other records) itemizing separately as to each security-based swap: (1) The type of security-based swap; (2) the reference security, index, or obligor; (3) date and time of execution; (4) the effective date; (5) the termination or maturity date; (6) the notional amount; (7) the unique transaction identifier; and (8) the unique counterparty identifier.

The proposal would require stand-alone SBSDs and stand-alone MSBSPs to make and keep current the same types of ledgers (or other records). However, it would require bank SBSDs and bank MSBSPs to make and keep current ledger accounts (or other records) relating to securities and commodity transactions, but only with respect to their security-based swap customers and non-customers.

SIFMA has similar comments on the Commission's proposal relating to ledger accounts as it did on other aspects of the Commission's proposal: the Commission should permit flexibility and not define ledger account in a way that would be inconsistent with the CFTC's approach. In addition, as noted above, we believe that the Commission should make the use of LEIs mandatory, but allow firms flexibility to use internal codes to identify counterparties that they can map to LEIs.[33]

- ***Recommendation:*** *The Commission should allow flexibility in how a "ledger account" is understood and operationalized, and not mandate a detailed specified format, to enable SBSDs and MSBSPs to have flexibility in how they keep and maintain required records relating to security-based swaps. Furthermore, the Commission should not define or interpret a "ledger account" in a way that would be inconsistent with the CFTC's concept of a "ledger account."*

2. Daily Margin Calculation

The Commission has proposed Rule 18a–3 under the Exchange Act, which would establish margin requirements with respect to noncleared security-based swaps applicable to nonbank SBSDs and nonbank MSBSPs.[34] The Commission is proposing to require that nonbank SBSDs and nonbank MSBSPs make and keep current a record of the daily calculations that would be required under proposed Rule 18a–3 by amending Rule 17a–3 and including a parallel provision in paragraph (a) of proposed Rule 18a–5 applicable to nonbank SBSDs and nonbank MSBSPs.

- ***Recommendation:*** *SIFMA supports the Commission's proposed recordkeeping requirements relating to the daily margin calculation, but we request that the Commission consider the concerns that we raised regarding the Commission's margin*

[33] *See* note 25, *supra*.

[34] *See* SEC Capital and Margin Proposal at 70274-88.

proposal in the SIFMA Comment Letter on SEC Capital and Margin Proposal and the SIFMA Comment Letter on Margin for Uncleared Swaps.

D. Accountholder, Associated Persons, and Business Conduct

1. Accountholder Information

The proposal relating to accountholder information is modeled on paragraph (a)(9) of Rule 17a–3, which requires broker-dealers to make and keep current certain information with respect to each securities accountholder. The Commission is proposing to amend paragraph (a)(9) to require certain information with respect to security-based swap accountholders, and to include similar requirements in paragraphs (a) and (b) of proposed Rule 18a–5. Specifically, the proposal would require broker-dealers, SBSDs, and MSBSPs to make and keep current, in the case of a security-based swap account: (1) A record of the unique counterparty identifier of the accountholder; (2) the name and address of accountholder; and (3) the signature of each person authorized to transact business in the security-based swap account.

SIFMA generally supports the Commission's proposal to require that broker-dealers, SBSDs, and MSBSPs obtain certain information regarding their security-based swap accountholders. In particular, SIFMA supports the requirement to require a record of the unique counterparty identifier of each accountholder. As noted above, we believe that the Commission should make the use of LEIs mandatory, but also allow firms flexibility to use identify counterparties with internal codes that they can map to LEIs.

With respect to the requirement to obtain a signature of each person authorized to transact business in the security-based swap account, we note that this requirement originated in a time when securities transactions were largely documented in paper. With the increasing use of electronic communications and electronic trading platforms, it is not common practice in the swaps market to obtain actual signatures of persons authorized to transact business on behalf of a counterparty in a swaps account. Instead, broker-dealers, SBSDs, and MSBSPs should be permitted to satisfy this requirement by establishing policies and procedures relating to counterparty trade authorization.

- ***Recommendation:*** *The Commission should make the use of LEIs mandatory, although it should permit firms to use different counterparty identifiers for internal firm purposes as long as they are able to translate their internal counterparty identifiers into the standard LEI convention.*[35] *Furthermore, the Commission should permit broker-dealers, SBSDs, and MSBSPs to satisfy the requirement to obtain signatures of persons authorized to trade on behalf of counterparties by establishing policies and procedures relating to counterparty trade authorization.*

[35] *See* note 25, *supra*.

2. Associated Persons

The proposal relating to associated person information is modeled on paragraph (a)(12) of Rule 17a–3, which requires broker-dealers to make and keep current records of a wide range of information about associated persons of the broker-dealer. Because Rule 17a-3(a)(12) already applies to broker-dealer SBSDs and broker-dealer MSBSPs, the Commission is not proposing to amend paragraph (a)(12) to account for security-based swaps. The Commission, however, is proposing to include parallel provisions in paragraphs (a) and (b) of proposed Rule 18a–5 Consequently, stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs would be required to make and keep current a questionnaire or application for employment for each associated person, which must include the associated person's identifying information, business affiliations for the past ten years, relevant disciplinary history, relevant criminal record, and place of business, among other things. Bank SBSDs and bank MSBSPs would be subject to the rule only with respect to associated persons whose activities relate to the conduct of their business as an SBSD or MSBSP.

For this purpose, the term "associated person" means: "(i) any partner, officer, director, or branch manager of such security-based swap dealer or major security-based swap participant (or any person occupying a similar status or performing similar functions); (ii) any person directly or indirectly controlling, controlled by, or under common control with such security based swap dealer or major security-based swap participant; or (iii) any employee of such security-based swap dealer or major security-based swap participant."[36] As a result of this broad definition, under the Commission's proposal, stand-alone SBSDs and stand-alone MSBSPs, and to a lesser extent bank SBSDs and bank MSBSPs, would be required to make and keep current records of a wide range of information about a broad group of personnel.

However, in its proposed rules regarding registration of SBSDs and MSBSPs, the Commission had proposed to require each SBSD and MSBSP to obtain information regarding associated persons solely for the purpose of supporting an SBSD's or MSBSP's required certification that none of its associated persons that effect, or are involved in effecting, security-based swaps on the SBSD's or MSBSP's behalf is subject to a statutory disqualification.[37] Specifically, paragraph (b) of proposed Rule 15Fb6–1 under the Exchange Act would require each SBSD and MSBSP to obtain a questionnaire or application for employment executed by each of its associated persons that "effect or are involved in effecting" security-based swaps on

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[36] Section 3(a)(70) of the Exchange Act, as added by Section 761(a)(6) of the Dodd-Frank Act. This definition does not include persons whose functions are solely clerical or ministerial.

[37] Section 15F(b)(6), as added by Section 764(a) of the Dodd-Frank Act, provides: "Except to the extent otherwise specifically provided by rule, regulation, or order of the Commission, it shall be unlawful for a security-based swap dealer or a major security-based swap participant to permit any person associated with a security-based swap dealer or a major security-based swap participant who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant, if the security-based swap dealer or major security-based swap participant knew, or in the exercise of reasonable care should have known, of the statutory disqualification" (emphasis added).

its behalf.[38] Such questionnaire or application is intended by the Commission to serve as a basis for a background check of the associated person to determine whether the associated person is statutorily disqualified.

Although the SEC Registration Proposal limits the scope of associated persons from which an SBSD or MSBSP would be required to obtain information, the SEC Recordkeeping Proposal dramatically extends the scope of this requirement to all associated persons. The Commission does so without providing a policy rationale for departing from the Commission's registration proposal on this point or provide an analysis of the costs and benefits of the new approach, which will clearly impose significant additional costs on non-broker-dealer SBSDs and MSBSPs.[39]

While recognizing the need to ensure that associated persons are not subject to statutory disqualifications, consistent with our comments above, SIFMA recommends that the Commission harmonize its proposal with the approach taken by the CFTC in its final rules governing SD and MSP registration. The CFTC provides firms flexibility in complying with the statutory disqualification prohibition relating to associated persons of SDs and MSPs, including allowing for the National Futures Association or other service provider to vet potential associated persons for statutory disqualifications.[40]

At a minimum, however, SIFMA recommends that the Commission modify the recordkeeping proposal to make it consistent with the SEC Registration Proposal and, therefore, require an SBSD or MSBSP to obtain information only from associated persons who "effect or are involved in effecting" security-based swaps on its behalf. In addition, as we argued in our previous comments to the Commission in connection with the SEC Registration Proposal, the Commission should remove or, in the alternative, narrow the scope of, and provide exceptions

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[38] The Commission defines associated persons "involved in effecting" security-based swaps to include, but not be limited to: "persons involved in drafting and negotiating master agreements and confirmations, persons recommending security-based swap transactions to counterparties, persons on a trading desk actively involved in effecting security-based swap transactions, persons pricing security-based swap positions and managing collateral for the SBS Entity, and persons assuring that the SBS Entity's security-based swap business operates in compliance with applicable regulations. In short, the term would encompass persons engaged in functions necessary to facilitate the SBS Entity's security-based swap business." *See* SEC Registration Proposal at 65795 n.56.

[39] *See* SIFMA Comment Letter on SEC Registration Proposal at 7 (arguing that the Commission significantly underestimated the burden the proposal's associated person investigation requirement would impose on prospective SBSDs and MSBSPs and questioning the Commission's estimate of how many associated persons would be subject to the required investigation). This burden would be significantly increased if the requirement applied to all associated persons through the backdoor of the recordkeeping rules.

[40] *See* CFTC, Registration of Swap Dealers and Major Swap Participants, 77 Fed. Reg. 2613, 2615-16 (Jan. 19, 2012), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2012-01-19/pdf/2012-792.pdf.

from, the associated person investigation requirement to make it clearer which associated persons are covered by the requirement.[41]

Moreover, SIFMA is concerned about the vagueness of the proposed limitation on the scope of the requirement with respect to bank SBSDs and bank MSBSPs, which are only required to keep records of every associated person whose "activities relate to the conduct of the business" of the SBSD or MSBSP. It is unclear what activities this is intended to capture. SIFMA recommends that the Commission limit the requirement to associated persons who effect or are involved in effecting security-based swaps on its behalf, narrowly defined, as recommended above.

Below we discuss application of this requirement to foreign SBSDs and foreign MSBSPs, which raises a number of difficult issues as a result of foreign privacy, secrecy, and blocking laws.[42]

- ***Recommendation:*** *The Commission should harmonize its proposal with the CFTC's approach to addressing the statutory disqualification prohibition for associated persons of SDs and MSPs. At a minimum, however, the Commission should modify the recordkeeping proposal to make it consistent with the SEC Registration Proposal and, therefore, only require an SBSD or MSBSP to obtain information from associated persons that effect or are involved in effecting security-based swaps on its behalf. The Commission also should remove or, in the alternative, narrow the scope of and provide exceptions from the associated person investigation requirement. Furthermore, the Commission should limit the requirement for a bank SBSD or bank MSBSP to obtain information from every associated person whose "activities relate to the conduct of the business of the SBSD or MSBSP" to those associated persons who effect or are involved in effecting security-based swaps on its behalf.*

3. External Business Conduct Standards

To promote compliance with previously proposed external business conduct standards, the Commission is proposing to amend Rule 17a–3 and to include parallel provisions in paragraphs (a) and (b) of proposed Rule 18a–5 to require SBSDs and MSBSPs to make and keep current a record that demonstrates their compliance with proposed external business conduct rules, as applicable. The proposal would require SBSDs and MSBSPs to keep supporting documents evidencing their compliance with the business conduct standards; the Commission states that a mere attestation of compliance would not be sufficient.

While SIFMA generally supports this aspect of the proposal, we request that the Commission confirm that the requirement for SBSDs and MSBSPs to keep "supporting documents evidencing their compliance with the business conduct standards," as applicable, is consistent with the requirement in proposed Rule 15Fk-1(b)(5) of the SEC Business Conduct

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[41] *See* SIFMA Comment Letter on SEC Registration Proposal at 7-9.

[42] *See* Sections VI.D and VI.F.2, *infra*.

Proposal that the chief compliance officer of an SBSD or MSBSP establish, maintain and review policies and procedures reasonably designed to ensure compliance with the provisions of the Exchange Act and the rules and regulations thereunder relating to the SBSD's or MSBSP's business as an SBSD or MSBSP.[43] If the Commission intends to impose additional requirements with respect to compliance with its proposed business conduct standards, the Commission should clearly state what those new proposed requirements are, explain how they relate to what was previously proposed (*e.g.*, how they are different), and provide a sufficient justification for the proposed new requirements, including performing an adequate cost-benefit analysis.

In addition, the Commission requests comment on whether it should require broker-dealer SBSDs, stand-alone SBSDs, and bank SBSDs to make and keep a record that demonstrates they have complied with the business conduct standards required under proposed Rule 15Fh-6 under the Exchange Act (regarding political contributions by certain SBSDs).[44] To begin with, as we commented previously, the Dodd-Frank Act did not mandate any restrictions on political contributions by SBSDs, and so it is not clear to us that the Commission needs to impose such a requirement on a discretionary basis.[45] In this connection, we note that the regulations promulgated by the Municipal Securities Rulemaking Board on political contributions made in connection with municipal securities business will already cover most SBSDs doing business with municipal entities, and so there may not be much marginal benefit to imposing additional restrictions on SBSDs generally.[46] For similar reasons, we do not think the Commission should adopt additional recordkeeping rules relating to the proposed pay to play rules. Finally, we believe that such recordkeeping rules would be unnecessary because the Commission already is proposing to require SBSDs to establish, maintain, and review policies and procedures reasonably designed to ensure compliance with the provisions of the Exchange Act and the rules and regulations thereunder relating to the SBSD's or MSBSP's business as an SBSD or MSBSP.[47] Therefore, it is not necessary for the Commission to adopt prescriptive recordkeeping rules relating to pay to play provisions, such as described in its request for comment, to achieve its regulatory objectives.

- ***Recommendation:*** *The Commission should confirm that the SEC Recordkeeping Proposal is not proposing to create additional recordkeeping obligations with respect to business conduct standards set forth in the SEC Business Conduct Proposal, particularly with respect to the requirements relating to compliance with such requirements. Furthermore, the Commission should not adopt additional recordkeeping rules relating to the pay to play provisions proposed in the SEC Business Conduct Proposal.*

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[43] *See* SEC Business Conduct Proposal. The reference in the SEC Business Conduct Proposal to a "documented system for applying those policies and procedures" occurs only in proposed Rule 15Fh-3(h)(3)(i) as something of a safe harbor from being deemed to have failed to diligently supervise. *See also* SIFMA Comment Letter on SEC Business Conduct Proposal.

[44] *See* SEC Recordkeeping Proposal at 25209.

[45] See SIFMA Comment Letter on SEC Business Conduct Proposal at 21. *See also id*. at 22-23.

[46] See SIFMA Comment Letter on SEC Business Conduct Proposal at 21-22.

[47] *See* note 43, *supra*.

E. Capital, Liquidity, and Customer Protection

1. Trial Balances and Computation of Net Capital

Paragraph (a)(11) of Rule 17a–3 requires broker-dealers to make and keep current 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 Rule 15c3–1 under the Exchange Act. The Commission is not proposing to amend paragraph (a)(11) to account for security-based swaps because the impact of security-based swaps on those computations is reflected in the amendments to the capital rules that have been proposed by the Commission to apply to broker-dealer SBSDs and stand-alone SBSDs. The Commission is proposing to include a parallel requirement in paragraph (a)(9) of proposed Rule 18a–5 applicable to stand-alone SBSDs and stand-alone MSBSPs, but not a parallel requirement for bank SBSDs or bank MSBSPs.

While we recognize the importance of including recordkeeping and reporting requirements with respect to trial balances and computation of net capital, we strongly urge the Commission to modify its proposed net capital requirements for SBSDs and MSBSPs to address comments SIFMA has raised regarding the proposal.[48] In particular, we are concerned that the proposed requirement to tie an SBSD's minimum level of net capital to 8% of the level of margin required to be collected by it with respect to security-based swaps would require the maintenance of resources far in excess of the actual risks presented by an SBSD's exposures.[49] As we have explained at length elsewhere, we recommend that the Commission adopt two alternatives to the proposed 8% margin factor that would more effectively be tailored to the risk presented by an SBSD's activities: (a) for stand-alone SBSDs that use internal models and ANC broker-dealers, a ratio based on a percentage of the entity's market and credit risk charges to capital and (b) for stand-alone and broker-dealer SBSDs that do not use internal models, a ratio based on a credit quality adjusted version of the proposed 8% margin factor.[50] If the Commission determines to adopt a margin factor that is additive to net capital, we strongly urge the Commission to discuss with interested constituencies the potential impact of any such margin factor before adopting it. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.[51]

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[48] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal; *see also* SIFMA Comment Letter on Margin for Uncleared Swaps. The Executive Summaries contained in these letters are provided in Appendices A and B.

[49] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal at 2-8 (discussing the reasons why the proposed 8% margin factor is not appropriately risk-based).

[50] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal at 8-13.

[51] In addition, we would like to reiterate our previous comments regarding (i) the third-party custodian deduction and (ii) the legacy account deduction. In our comments, we suggested alternatives to these proposals that were intended to be more risk sensitive and less disruptive to the security-based swap market.

- ***Recommendation:*** *The Commission should modify the proposed net capital requirements for SBSDs and MSBSPs as described above.*

2. Liquidity Stress Tests

The Commission has proposed that certain broker-dealers, including broker-dealer SBSDs, and certain stand-alone SBSDs be subject to liquidity stress test requirements.[52] The Commission is proposing to amend Rule 17a–3 to add a requirement that ANC broker-dealers, including ANC broker-dealer SBSDs, make and keep current a report of the results of the monthly liquidity stress test, a record of the assumptions underlying the liquidity stress test, and the liquidity funding plan required under the proposed amendments to Rule 15c3–1. The Commission is proposing to include a parallel requirement in paragraph (a) of proposed Rule 18a–5 applicable to stand-alone SBSDs and stand-alone MSBSPs, but not a parallel requirement for bank SBSDs and bank MSBSPs.

While we recognize the importance of including recordkeeping and reporting requirements with respect to liquidity stress tests, we strongly urge the Commission to modify its proposed liquidity stress test requirements as follows:

- ***Liquid asset standards***. The Commission's liquidity rulemaking for broker-dealers and SBSDs should rely on the High Quality Liquid Asset ("**HQLA**") standard adopted by the Federal Reserve in the Liquidity Coverage Ratio ("**LCR**") regime.

- ***Intraday liquidity***. The Commission's liquidity rulemaking for broker-dealers and SBSDs should permit firms to use liquidity resources on an intraday basis so long as they comply with end-of-day standards.

With respect to the legacy account deduction, we recommend that the Commission should modify the legacy account deduction by instead adopting either a credit risk charge or a credit concentration charge, with an exception permitting SBSDs to elect to exclude from accounts subject to the charge any currently uncleared positions in a type of security-based swap for which a clearing agency has made an application to the Commission to accept for clearing. See SIFMA Comment Letter on SEC Capital and Margin Proposal at 24-27.

With respect to the third-party custodian deduction, to address the SBSD's credit risk to the custodian, the Commission could require that, under the arrangement the custody account is maintained with a "bank" (as defined in Section 3(a)(6) of the Exchange Act), U.S. broker-dealer, or non-U.S. bank or broker-dealer that has total regulatory or net capital in excess of $1 billion (such bank or broker-dealer, the "custodian"). Such custodian should be permitted to include an affiliate of the SBSD. Furthermore, the Commission should address any concerns it has regarding custodial arrangements directly through rules regarding the terms and conditions of such arrangements, for bank and nonbank SBSDs alike. See SIFMA Comment Letter on SEC Capital and Margin Proposal at 24-27.

The Commission should adopt one of the alternatives we have recommended and make corresponding changes, as applicable, to the SEC Recordkeeping proposal.

[52] *See* SEC Capital and Margin Proposal at 70252-54.

- ***Holdco/subsidiary alignment***. Under appropriate circumstances, the Commission should recognize HQLAs held by a broker-dealer/SBSD's parent company as supporting the subsidiary entity's liquidity. Conditions to this requirement could include:

  (1) Parent company is subject to LCR on a consolidated basis;

  (2) Parent company has submitted a resolution plan to the Federal Reserve and FDIC;

  (3) The resolution plan anticipates the broker-dealer/SBSD receiving liquidity support in the event of material financial distress at the Parent company; and

  (4) The Federal Reserve/FDIC have not objected to the Parent company's resolution plan.[53]

We would be pleased to discuss this proposal with Commission staff.

➢ ***Recommendation***: *The Commission should modify the proposed stress test requirements for SBSDs consistent with the recommendations above.*

3. Possession or Control

Rule 15c3–3 under the Exchange Act requires a broker-dealer that carries customer securities or cash (a "carrying broker-dealer") to maintain physical possession or control over customers' fully paid and excess margin securities. The Commission has proposed Rule 18a–4 under the Exchange Act to establish security-based swap customer protection requirements that are modeled on the requirements in Rule 15c3–3. Paragraph (b)(1) of proposed Rule 18a–4 would require an SBSD to promptly obtain and thereafter maintain physical possession or control of all excess securities collateral carried for the accounts of security-based swap customers.

The Commission is proposing to require that all SBSDs make and keep current a record of compliance with the possession or control requirement under proposed Rule 18a–4 by amending Rule 17a–3 to add this new requirement and including parallel requirements in paragraphs (a) and (b) of proposed Rule 18a–5. Consequently, this new recordkeeping requirement would apply to broker-dealer SBSDs, stand-alone SBSDs, and bank SBSDs. The records required under this proposal would need to document that each business day the firm took the steps required under paragraph (b) of proposed Rule 18a–3.

While we recognize the importance of including recordkeeping and reporting requirements with respect to possession or control requirements, we strongly urge the

[53] Suggested revisions to proposed Rule 18a-1 under the Exchange Act are set forth in Appendix C. *See* SIFMA, "SEC Liquidity Presentation" (Jan. 10, 2014), *available at:* http://www.sec.gov/comments/s7-08-12/s70812-55.pdf. *See also* SIFMA Comment Letter on SEC Capital and Margin Proposal at 30-32.

Commission to modify the possession or control requirements in proposed Rule 18a-4 to address certain technical questions and issues that we think need to be addressed for the proposed requirements to be made consistent with Rule 15c3-3 and to accommodate the funding and hedging practices of dealers in OTC derivatives.[54]

- ***Recommendation:*** *The Commission should modify its proposal to address certain technical questions and issues that need to be addressed for the proposed requirements to be made consistent with Rule 15c3-3 and to accommodate the funding and hedging practices of dealers in OTC derivatives, as outlined in the SIFMA Comment Letter on SEC Capital and Margin Proposal.*

4. Reserve Computation

Rule 15c3–3 requires a carrying broker-dealer to maintain a reserve of funds or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers. The Commission has proposed a parallel requirement in proposed Rule 18a–4. The Commission is proposing to require that all types of SBSDs make and keep current a record of their reserve computations under proposed Rule 18a–4 by amending Rule 17a–3 to add the requirement and to include parallel requirements in paragraphs (a) and (b) of proposed Rule 18a–5.

While we recognize the importance of including recordkeeping and reporting requirements with respect to the reserve computation, we strongly urge the Commission to modify the proposed customer reserve account requirements to address certain technical questions and issues that we think need to be addressed for the proposed requirements to be made consistent with Rule 15c3-3 and to accommodate the funding and hedging practices of dealers in OTC derivatives.[55]

- ***Recommendation:*** *The Commission should modify its proposal to address certain technical questions and issues that need to be addressed for the proposed requirements to be made consistent with Rule 15c3-3 and to accommodate the funding and hedging practices of dealers in OTC derivatives, as outlined in the SIFMA Comment Letter on SEC Capital and Margin Proposal.*

IV. Record Retention

A. Voice Records

The Commission is proposing to amend the preservation requirement in paragraph (b)(4) of Rule 17a–4 to include recordings of telephone calls required to be maintained pursuant to Section 15F(g)(1) of the Exchange Act (*i.e.*, in connection with security-based swap transactions). Under this proposed requirement, a broker-dealer SBSD or a broker-dealer MSBSP would be required to preserve for three years telephone calls that it chooses to record to the extent the calls are related to security-based swap transactions. The Commission is

[54] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal at 47-50.

[55] *See Id*.

proposing to include parallel communication preservation requirements for stand-alone SBSDs, stand-alone MSBSPs, bank SBSDs, and bank MSBSPs modeled on paragraph (b)(4) of Rule 17a–4. The requirements relating to bank SBSDs and bank MSBSPs would be limited to the registrant's business as an SBSD or MSBSP.

SIFMA supports the Commission's decision to make voice recordings voluntary and only to require the retention of voice recordings an SBSD or MSBSP voluntarily chooses to record.[56] We are concerned, however, by the Commission's three-year retention period requirement for voice recordings that are voluntarily made. The CFTC, which requires firms to create certain voice recordings, only requires firms to maintain such records for one year. Firms will frequently make voice recordings of swap transactions to comply with CFTC regulations. In many cases, it will be difficult, if not impossible, for dually registered firms to separate recordings relating to swaps from recordings relating to security-based swaps, given the inter-connectedness of the product sets. Thus, dually registered firms may be put in a position where they effectively have to maintain voice recordings for both swap and security-based swap activity for the Commission's longer three-year retention period, even though the Commission does not mandate voice recordings in the first place. We do not think it would be appropriate to impose the three-year requirement, when the primary reason for the recordings is compliance with the CFTC policy, as it would impose additional cost without a corresponding regulatory benefit. Therefore, we recommend that the Commission limit the record retention period for voice recordings to one year, consistent with the CFTC's approach.

- ***Recommendation:*** *The Commission should limit the record retention period for voluntarily recorded voice records to one year, consistent with the CFTC's approach.*

B. WORM Storage Challenges

The Commission is proposing to include in proposed Rule 18a-6 a record maintenance and preservation requirement, with respect to electronic storage media, for stand-alone SBDSs/MSBSPs and bank SBSDs/MSBSPs that is parallel to the requirements currently applicable to broker-dealers in Rule 17a-4(f) under the Exchange Act. Among other things, the electronic media storage must preserve the records exclusively in a non-rewritable, non-erasable format. This format is often referred to as "write once, read many," or "WORM."

SIFMA has approached the CFTC and Commission staff to request a wholesale review of the WORM storage requirements for electronic records. Given the many advances in technology and the increasing complexity of records, SIFMA believes that the WORM standard is no longer the most efficient or effective standard for retaining electronic records. The rapid evolution of complex content from social media, voice recordings, and ledgers, which often cannot be archived in discrete documentary form, have further highlighted challenges to retaining records in WORM format. SIFMA is advocating for a principles-based standard in lieu of the WORM technology-based standard. A principles-based standard would include security and audit requirements that would ensure the integrity and retrievability of records in a more efficient and effective manner, while still preserving WORM as an acceptable format. Our discussions with

[56] *See* SEC Recordkeeping Proposal at 25266.

the CFTC and the Commission are ongoing, but we urge the Commission not to expand the WORM requirements to SBSDs at this time.

For these reasons, and reasons we have expressed elsewhere in other contexts,[57] we do not support the use of WORM technology with respect to electronically stored SBSD or MSBSP records.

- ***Recommendation:*** *The Commission should not mandate the use of WORM storage systems for SBSDs and MSBSPs. Furthermore, the Commission should not mandate the use of WORM storage systems more generally, including for broker-dealers who may be dually-registered as SBSDs.*

V. Reporting

The Commission is proposing new FOCUS Report Form SBS ("**Form SBS**") that would be used by all types of SBSDs and MSBSPs to report financial and operational information and, in the case of broker-dealer SBSDs and broker-dealer MSBSPs, replace their use of Part II, Part IIA, Part IIB, or Part II CSE of the Financial and Operational Combined Uniform Single Report ("**FOCUS Report**"). Under the proposal, different reporting rules would apply to broker-dealer SBSDs/MSBSPs, stand-alone SBSDs/MSBSPs, and bank SBSDs/MSBSP, given the differences in their business operations and the Commission's authority over them. The reporting program is modeled on the reporting program for broker-dealers in Rule 17a–5 under the Exchange Act. Rule 17a–5 has two main elements: (i) a requirement that broker-dealers file periodic unaudited reports containing information about their financial and operational condition on a FOCUS Report; and (ii) a requirement that broker-dealers annually file financial statements and certain reports and a report covering the financial statements and reports prepared by an independent public accountant registered with the Public Company Accounting Oversight Board ("**PCAOB**") in accordance with PCAOB standards.

SIFMA recognizes the importance that reporting requirements play in promoting transparency of the financial and operational condition of a firm to the Commission, the firm's designated examining authority, and (in the case of a portion of the annual reports) to the public. SIFMA also supports the Commission's decision to tailor the reporting requirements to different types of registrants. Nevertheless, we have a number of serious concerns with proposed Form SBS, some of which are as follows:

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[57] Because SIFMA believes that the WORM requirement imposes additional costs and inefficiencies in the recordkeeping process, we are seeking to eliminate this requirement for broker-dealers as well. *See* SEC Interpretation: Electronic Storage of Broker-Dealer Records, Release No. 34-44238 (May 1, 2001), 66 Fed. Reg. 22916 (May 7, 2001), *available at:* http://www.sec.gov/rules/interp/34-47806.htm. *See also* SIA comment letter to the SEC re. Amendment to Rules under the Investment Company and Investment Adviser Acts (Apr. 19, 2001), *available at:* https://www.sifma.org/issues/item.aspx?id=1209; SIA comment letter on a proposal relating to modernizing the SEC's electronic storage rule (Feb. 21, 2003), *available at:* http://www.sifma.org/issues/item.aspx?id=1014; and SIFMA comment letter to the SEC on electronic records retention (Dec. 19, 2007), *available at:* http://www.sifma.org/issues/item.aspx?id=208.

- ***Proposed Form SBS is not tailored to the unique characteristics of security-based swaps***. We are concerned that proposed Form SBS, without further modification, would not adequately reflect the differences between security-based swaps and most securities. As we discussed above, the ongoing contractual relationship between parties distinguishes a security-based swap from most securities and is reflected in the different ways in which security-based swaps and most securities are treated for recordkeeping purposes.[58] Also, as discussed above, many terms and concepts that are more appropriate for debt and equity securities are not really applicable to security-based swaps – for example, terms like "longs and shorts." Thus, in many places, proposed Form SBS is not sufficiently tailored to security-based swap activity as opposed to the traditional securities activity of broker-dealers.

- ***Proposed Form SBS contains requests for information that are unclear or incomplete***. In part because proposed Form SBS is not adequately tailored to reflect the unique characteristics of security-based swaps, it is unclear, in a number of places, what information proposed Form SBS is trying to elicit from firms. The request for information also is incomplete in several places. Examples of places where proposed Form SBS is unclear or incomplete are included in Appendix D.

- ***Parts 4 and 5 of proposed Form SBS contain schedules that are treated as part of proposed Form SBS rather than as supplemental to the form.*** As with the schedules to the Focus Report for broker-dealers, SIFMA requests that the schedules in Parts 4 and 5 of proposed Form SBS not be treated as part of proposed Form SBS, but rather that they be treated as supplementary schedules.

- ***Proposed Form SBS does not adequately address the concerns of U.S. and foreign bank SBSDs and bank MSBSPs.*** Examples of how proposed Form SBS does not adequately address the concerns of U.S. and foreign bank SBSDs and bank MSBSPs are included in Appendix E.

- ***Proposed Form SBS reflects aspects of the SEC Capital and Margin Proposal that should be modified***. We are concerned that proposed Form SBS reflects a decision on the part of the Commission to adopt certain of the proposals contained in the SEC Capital and Margin Proposal, most notably the proposed 8% margin factor. As we have previously commented, we have serious concerns regarding certain aspects of the SEC Capital and Margin Proposal, which we think will impose costs that are disproportionate to the risks of security-based swap dealing activity.[59] In particular, as noted above, we are concerned that the proposed requirement to tie an SBSD's minimum level of net capital to 8% of the level of margin required to be collected by

[58] *See* Section II.A., *supra*.

[59] As noted above, Appendices A and B of this letter contain the executive summaries of the SIFMA Comment Letter on SEC Capital and Margin Proposal and the SIFMA Comment Letter on Margin for Uncleared Swaps, respectively. We encourage the Commission to reconsider the fuller discussion of these points in the referenced comment letters.

it with respect to security-based swaps would require the maintenance of resources far in excess of the actual risks presented by an SBSD's exposures.[60]

Rather than attempting to rewrite, or provide detailed annotations on, proposed Form SBS, we believe it would be more fruitful for the Commission to enter into a constructive dialogue with interested constituencies to discuss the various parts of proposed Form SBS in more detail, with the goal of developing a reporting regime that both is workable for SBSDs and MSBSPs and achieves the Commission's regulatory objectives. SIFMA would be pleased to work with Commission staff to facilitate such a consultation.

- ***Recommendation:*** *Given some of the problems identified above, the Commission should enter into a constructive dialogue with interested constituencies with the goal of developing a reporting regime that both is workable for SBSDs and MSBSPs and achieves the Commission's regulatory objectives. At a minimum, the Commission should revise proposed Form SBS to reflect the differences between security-based swap activity and traditional securities activity and address the other concerns raised above.*

VI. Cross-Border Considerations

The Commission did not address the application of its proposed recordkeeping and reporting requirements in the cross-border context in the SEC Recordkeeping Proposal or in the final cross-border rules the Commission adopted in June of this year.[61] In the Commission's cross-border proposal, such requirements were preliminarily considered "entity-level requirements" because the Commission believed that such requirements provided the Commission with vital information in connection with its oversight of registrants.[62] However, the Commission solicited comment regarding the cross-border application of the recordkeeping and reporting requirements, which had not yet been proposed at the time of the SEC Cross-Border Proposal.

As discussed below, SIFMA has a number of concerns regarding the application of the recordkeeping and reporting requirements to foreign SBSDs, foreign MSBSPs, and foreign branches of U.S. banks.

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[60] *See* SIFMA Comment Letter on SEC Capital and Margin Proposal, particularly at 2-8.

[61] *See* Application of the "Security-based Swap Dealer" and "Major Security-based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities; Republication, Release No. 34-72472 (June 25, 2014), 79 Fed. Reg. 47278 (Aug. 12, 2014, as corrected) ("**SEC Final Cross-Border Rules**), *available at*: http://www.gpo.gov/fdsys/pkg/FR-2014-08-12/pdf/R1-2014-15337.pdf.

[62] *See* SEC Cross-Border Proposal at 31013.

A. Classification and Application of Recordkeeping Requirements

The Commission has proposed to classify recordkeeping requirements, including requirements relating daily trading records and confirmations, as "entity-level requirements."[63] This is in contrast to the CFTC's approach, which classifies daily trading records and confirmations as transaction-level requirements.[64] As with uncleared swap margin, SIFMA believes that daily trading record and confirmation requirements should apply on a transaction-by-transaction basis rather than apply to an SBSD's security-based swap dealing more generally. Since both the application and, presumably, the enforcement of these requirements will be addressed at the transaction level, we believe that daily trading record and confirmation requirements are more appropriately categorized as transaction-level requirements.

Such a classification would enable the Commission to better tailor application of its recordkeeping requirements to foreign SBSDs and MSBSPs. Specifically, we believe that the Commission generally should not apply recordkeeping rules that are classified as transaction-level requirements to transactions by registered foreign SBSD (or registered U.S. SBSDs engaging in security-based swap dealing through foreign branches) with non-U.S. persons or foreign branches of U.S. banks. Such an approach would help promote the principles of comity, cooperation, and the harmonization of international security-based swap regulation, as well as consistency with the CFTC Cross-Border Release.

- ***Recommendation:*** *The Commission should classify requirements relating to daily trading records and confirmations as transaction-level requirements rather than entity-level requirements. Furthermore, the Commission should not apply such transaction-level requirements to transactions of foreign SBSDs (or registered U.S. SBSDs that engage in security-based swap dealing through foreign branches) with non-U.S. persons or foreign branches of U.S. banks.*

B. Application of Recordkeeping and Reporting Rules to Foreign Branches of U.S. Banks

As noted above, SIFMA recommends that the Commission permit a foreign SBSD or foreign MSBSP to satisfy its recordkeeping and reporting requirements by complying with recordkeeping and reporting rules established by its foreign regulator, provided such rules are comparable to Commission rules.[65] The opportunity for substituted compliance should be

[63] The Commission classified mandatory clearing, mandatory trade execution, and mandatory reporting as transaction-level requirements. These requirements are not the subject of this release or the present discussion.

[64] *See* CFTC, Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013) ("**CFTC Cross-Border Release**"), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf. The CFTC Cross-Border Release treats requirements relating to daily trading records, trade confirmations, swap trading relationship documentation, and portfolio reconciliation and compression, among others, as "transaction-level requirements."

[65] *See* Section I.C, *supra*.

extended to Foreign Branches (*i.e.*, registered bank SBSDs that engage in dealing activity through foreign branches) in transactions with non-U.S. persons or other Foreign Branches, with respect to the recordkeeping requirements that were classified above as "transaction-level requirements." The Commission already has proposed substituted compliance with respect to Foreign Branches for regulatory reporting, public dissemination, and trade execution.[66] The SEC Cross-Border Proposal does not, however, extend substituted compliance to Foreign Branches with respect to recordkeeping or any other requirements.[67]

To increase the equality of treatment of Foreign Branches and foreign SBSDs, Foreign Branches should be able to rely on substituted compliance determinations for the recordkeeping requirements that are classified as transaction-level requirements in respect of transactions with non-U.S. persons or Foreign Branches. The proposed disparate treatment of Foreign Branches and foreign SBSDs puts Foreign Branches at a competitive disadvantage, even though Foreign Branches are, in most cases, subject to extensive supervision and oversight in their host country, and substituted compliance would only be permitted where such comprehensive regulation exists. Consequently, to mitigate the competitive inequalities that result from disparate treatment of entities operating outside the United States, we believe that the final cross-border rule should allow Foreign Branches to benefit from the availability of substituted compliance for requirements relating to daily trading records, confirmations, and other transaction-level recordkeeping requirements.

- ***Recommendation:*** *Foreign Branches should be permitted to rely on substituted compliance with respect to requirements relating to daily trading records, confirmations, and other recordkeeping requirements that are classified as transaction-level requirements in transactions with non-U.S. persons or other Foreign Branches.*

C. Allocation of Duties

The SEC Cross-Border Proposal allows an SBSD to allocate Title VII duties to an agent, provided that the SBSD ultimately remains responsible for compliance with the applicable requirements. We support this provision and believe that it reflects the realities of the security-based swap market, in which agents often play a significant role. Furthermore, we appreciate that this allocation is permitted but optional, which we believe provides the flexibility necessary for the broad range of business relationships that exist in the security-based swap markets.

- ***Recommendation:*** *We support the Commission's decision to permit an SBSD to allocate duties to an agent.*[68]

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[66] *See* SEC Cross-Border Proposal at 31058-101.

[67] Under the SEC Cross-Border Proposal, only foreign SBSD are able to rely on substituted compliance, although Foreign Branches are provided certain relief with respect to transaction-level requirements relating to mandatory clearing, trade execution, and reporting.

[68] For example, when a foreign SBSD uses a U.S. broker-dealer to act as an agent in security-based swap transactions, such as in an arrangement similar to a Rule 15a-6(a)(3) "chaperoning arrangement," it could allocate its recordkeeping obligations to the U.S. broker-dealer.

D. Foreign Privacy, Secrecy, and Blocking Laws

We believe that additional time is needed for the Commission and market participants to address concerns arising from client confidentiality requirements under the local law of certain non-U.S. jurisdictions, some of which may even apply to transactions with U.S. persons. In addition, conducting criminal background checks on associated persons and disclosing their employment records may, among other things, be subject to fairly strict data privacy laws in certain countries that will prevent firms from sending this information outside of the country (such as to a U.S. regulator). This is a complicated issue that requires consultation with local regulators in each relevant jurisdiction. More than a dozen jurisdictions have been identified where local law prohibits the disclosure of client names to non-local regulators that do not currently have an information-sharing treaty or agreement in place with the local regulator, some of which cannot be satisfied by counterparty consent. The proposed recordkeeping rules may raise problems in such jurisdictions because local law may prohibit local entities from disclosing certain information regarding certain clients.

As this delicate issue requires more time for the Commission to consider and to develop possible alternative solutions, we believe that registered foreign SBSDs and foreign MSBSPs should be permitted to mask information regarding clients, associated persons, or such other persons as local laws require in any disclosures to the Commission, as part of an examination or for any other purpose, provided that the failure to do so would violate foreign legal requirements. The Commission should work with foreign regulators to address these problems. To the extent that these problems are not solved before foreign SBSD and MSBSP are required to register, market participants may need to ask for additional relief from specific requirements.

- ***Recommendation:*** *The Commission should take into account the issue of foreign jurisdictions' privacy, secrecy, and blocking laws.*

E. Other Cross-Border Issues

1. Accounting Standards for Foreign SBSDs and Foreign MSBSPs

As discussed in Section I.C above, there will be a number of foreign financial institutions required to register as SBSDs that are subject to prudential regulatory oversight and audited under the laws of their home jurisdiction. As proposed, the recordkeeping and reporting rules would require Foreign SBSDs to submit monthly reporting to the Commission under proposed Form SBS as well as annual financial reporting in accordance with U.S. GAAP. The requirements proposed by the Commission for stand-alone SBSDs are predicated on the assumption that the majority of such entities would be unregulated.[69]

Foreign SBSDs that are prudentially regulated in their home jurisdiction are already subject to extensive oversight and reporting obligations. Such Foreign SBSDs undertake financial and regulatory reporting. Generally such reporting would not be in accordance with U.S. GAAP standards, but rather with IFRS. This reporting is also typically submitted to home-

[69] *See* SEC Recordkeeping Proposal at 25290.

country prudential regulators on a quarterly basis. To require such Foreign SBSDs to prepare separate additional reports would lead to substantive costs which would not be commensurate with the benefits the Commission is seeking to obtain. In advance of making a substituted compliance determination for Foreign SBSDs, we believe the Commission should allow any required reporting by Foreign SBSDs to be undertaken in accordance with IFRS and on a quarterly basis for the following reasons:

- IFRS is a standard already recognized by the Commission: The Commission allows the use of IFRS for existing reporting frameworks,[70] and has been a strong supporter of the convergence of IFRS and U.S. GAAP standards through the efforts of the International Accounting Standards Board ("**IASB**") and the Financial Accounting Standards Board ("**FASB**"). Accepting reporting based on the use of IFRS will provide the Commission with comparably robust information which will allow for an analysis of financial condition of Foreign SBSD's utilizing the standard. SIFMA urges the Commission to act in accordance with the mandate of Section 752(a) of the Dodd-Frank Act to strive towards consistent international standards in accepting and acknowledging IFRS for Foreign SBSDs.

- Duplication of reporting standards and requirements: Foreign SBSDs face potential reporting obligations under two separate regimes and standards, *i.e.*, their home-country prudential regulators' standards and the Commission's proposed standards. As mentioned above, Foreign SBSDs that are prudentially regulated in their home jurisdiction generally provide reporting on a quarterly basis, whereas the Commission's proposal would materially increase the frequency of reporting required. One method of reducing the unnecessary compliance burden on such firms would be to allow reporting on a quarterly basis, and thus be in line with existing reporting frameworks, as well as the approach permitted for SBSDs which are subject to U.S. prudential regulation.

➢ ***Recommendation:*** *In advance of making substituted compliance determinations, the Commission should allow Foreign SBSDs to report information on a quarterly basis (in line with U.S. prudentially regulated SBSDs) in accordance with IFRS rather than U.S. GAAP.*

2. Obtaining Information from Associated Persons

In addition to the comments made above, we also believe that the scope of the requirement to obtain information regarding associated persons of an SBSD or MSBSP should not apply, in the case of foreign SBSDs, foreign MSBSPs, and Foreign Branches, to associated persons who effect or are involved in effecting transactions with non-U.S. persons or Foreign

[70] The SEC permits foreign private issuers to provide financial statements to the SEC in accordance with IFRS and no obligation to reconcile to U.S. GAAP. *See* SEC, Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Release No. 33-8879 (Dec. 21, 2007), 73 Fed. Reg. 986 (Jan. 4, 2008), *available at:* http://www.gpo.gov/fdsys/pkg/FR-2008-01-04/pdf/E7-25250.pdf.

Branches.[71] As noted above, the purpose of this requirement is to support an SBSD's or MSBSP's required certification that none of its associated persons effect, or are involved in effecting, security-based swaps on the SBSD's or MSBSP's behalf is subject to a statutory disqualification. Just as the Commission has proposed to limit the application of the external business conduct standards outside the United States, we do not think it is necessary or appropriate to apply the statutory disqualification provision to associated persons of foreign SBSDs or MSBSPs that are only involved in effecting transactions in connection with such entities' non-US person counterparties. Therefore, we believe the Commission should similarly limit the scope of information foreign SBSDs, foreign MSBPs, and Foreign Branches are required to obtain from their associated persons. In addition, we note that many of the associated persons of foreign SBSDs and foreign MSBSPs will not be U.S. citizens and, therefore, will not have some of the information required to be obtained under the rule (*e.g.*, social security numbers).

- ***Recommendation:*** *The Commission should not require foreign SBSDs, foreign MSBSPs, or Foreign Branches to obtain information regarding associated persons who effect or are involved in the effecting transactions solely with respect to their non-US person counterparties.*

VII. Phased Implementation of Recordkeeping and Reporting Requirements

An appropriate phase-in period for recordkeeping and reporting requirements is necessary to provide market participants with adequate time to build systems and technologies to record and report security-based swap activity. In most cases, complying with the proposal will require firms either to modify existing systems or to build entirely new systems. Given the complexity of the proposed rules and their interconnection with other Commission proposals, it will require much time to develop and test systems to ensure compliance with Commission regulations.

In addition, we urge the Commission not to impose implementation deadlines that conflict with the "code freeze" which typically occurs at year-end. Specifically, we suggest that the implementation dates should not fall in December or January (or, for Japanese firms, at the end of March). Financial institutions generally prohibit technological changes to their systems between early December and mid-January in an annual "code freeze." This practice is consistent with principles of prudential bank management and long-standing best practice across the industry, and was established in conjunction with the bank supervisory process. In addition, financial institutions are generally going through year-end book-closing processes in December or January (or, in Japan, at the end of March). Implementing any new procedures that will require systems changes is extremely difficult during the "code freeze" which typically occurs at year-end.

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[71] We note that the Commission did not address whether a transaction by a non-U.S. person with another non-U.S. person "conducted within the United States" would have been included in such non-U.S. person's SBSD *de minimis* threshold or otherwise trigger application of Title VII requirements. Given the significant issues raised by commenters on this proposed requirement, the Commission stated the final resolution of this issue could benefit from further consideration and public comment. *See* SEC Final Cross-Border Rules at 47279-80.

- ***Recommendation:*** *The Commission should phase in the recordkeeping and reporting requirements the later of (i) 12 months after the adoption of the SBS Recordkeeping Proposal or (ii) 12 months after the adoption of the SEC Capital and Margin Proposal. Furthermore, we urge the Commission not to impose implementation deadlines that conflict with the "code freeze" which typically occurs at year-end.*

* * *

SIFMA appreciates the opportunity to comment on the Commission's proposed recordkeeping, reporting, notification, and security count requirements for SBSDs and MSBSPs and welcomes any questions the Commission may have regarding these comments.

Respectfully submitted,

Mary Kay Scucci, PhD, CPA
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cc: Mary Jo White, Chairman
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Appendix A

EXECUTIVE SUMMARY[72]

SIFMA greatly appreciates the Commission's thoughtful effort to reconcile the many difficult and, in some cases, conflicting objectives that must be addressed in fashioning capital, margin and segregation requirements for nonbank SBSDs and MSBSPs. These objectives include the mandate in Section 15F(e) of the Exchange Act for the Commission's capital and margin requirements to "help ensure the safety and soundness" of nonbank SBSDs and MSBSPs and "be appropriate for the risk associated with" uncleared security-based swaps ("**SBS**"). Section 15F(e) also requires the Commission, together with the Commodity Futures Trading Commission (the "**CFTC**") and the Prudential Regulators,[73] to the maximum extent practicable, to establish and maintain comparable capital and margin requirements for bank and nonbank swap dealers ("**SDs**"), SBSDs, major swap participants ("**MSPs**") and MSBSPs. Section 752 of Dodd-Frank similarly requires the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to SBS. Finally, Section 3(f) of the Exchange Act generally requires the Commission to consider whether its rules "will promote efficiency, competition, and capital formation," and Section 23(a)(2) prohibits the Commission from adopting any rule that "would impose a burden on competition not necessary or appropriate in furtherance of the purposes" of the Exchange Act.

SIFMA recognizes that, in implementing capital, margin and segregation requirements for nonbank SBSDs, the Commission has largely drawn from its existing broker-dealer financial responsibility rules and sought to adapt those rules for SBSDs. Nevertheless, we are concerned that this approach, without further modification, does not adequately address or conform to the statutory principles described above. We strongly believe that, in applying those principles, the Commission should take into account the broader context of regulatory reform, including the significant reduction in risks that will occur once dealers and major participants in the SBS markets are required to register and comply with basic capital requirements, standardized SBS become subject to mandatory clearing and, for uncleared SBS, variation margin is required to be exchanged. Accordingly, the modifications that we recommend the Commission make to the Proposal are intended to be evaluated within that broader context.

The Proposal Would Impose Costs That Are Disproportionate to the Risks of SBS Dealing Activity. Contrary to the statutory requirements that the Commission's capital and margin requirements "be appropriate for the risk associated with" uncleared SBS and "promote efficiency," the Proposal would impose duplicative and excessive capital and margin requirements.

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[72] This executive summary is taken from the SIFMA Comment Letter on SEC Capital and Margin Proposal at ii-ix.

[73] Under Dodd-Frank, the "Prudential Regulators" are the Board of Governors of the Federal Reserve System ("**FRB**"), the Federal Deposit Insurance Corporation ("**FDIC**"), the Federal Housing Finance Agency ("**FHFA**"), the Farm Credit Administration ("**FCA**") and the Office of the Comptroller of the Currency ("**OCC**").

In particular, we are concerned that the proposed requirement to tie a SBSD's minimum level of net capital to 8% of the level of margin required to be collected by it with respect to SBS would require the maintenance of resources far in excess of the actual risks presented by a SBSD's exposures. Similarly, the proposed requirements to apply deductions to net capital based on the level of margin required for SBS would also be excessive, as well as inconsistent with the proposed capital regimes for SDs and banks SBSDs (*e.g.*, by requiring 100% deductions for collateral held by third-party custodians and legacy account positions). The six SIFMA member firms who operate alternative net capital ("**ANC**") broker-dealers have preliminarily projected that, in light of the severity of these requirements, the amount of capital that would be required for the single business line of SBS dealing under the Proposal would exceed $87 billion, the amount of capital currently devoted to all of those firms' securities businesses combined, including investment banking, prime brokerage, market making and retail brokerage.[74]

We also believe that entity-level liquidity stress test requirements are likely to be destabilizing by trapping assets within SBSD subsidiaries and preventing centralized liquidity risk management. Given the limits on available liquid assets, it is more systemically sound for liquidity to be managed in an integrated, group-wide manner, so that a subsidiary with excess liquidity can provide resources to one that is under stress. There is no empirical evidence, nor do we believe, that the risks arising from the SBS dealing business are greater than the aggregate risks arising from all of these other businesses. Furthermore, we believe that Dodd-Frank's reforms, most notably the significant expansion of central clearing and daily exchange of variation margin for uncleared SBS, will significantly decrease the risk in the SBS dealing business

Additionally, SIFMA is concerned that mandatory initial margin requirements would replace potential exposure with actual exposure, reduce overall market liquidity, exacerbate pro-cyclical shocks and, if extended universally, place margin in the hands of entities not subject to prudential supervision. While we appreciate the Commission's efforts to mitigate these adverse impacts by proposing to limit initial margin requirements to the collection of initial margin by SBSDs from financial end users, even such limited initial margin requirements will have negative consequences. In this regard, SIFMA member firms have estimated that the liquidity demands associated with mandatory initial margin requirements are likely to range between approximately $1.1 trillion (if dealers are not required to collect from each other) to $3 trillion (if dealers must collect from each other) to $4.1 trillion (if dealers must post to non-dealers).[75]

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[74] The firms estimated the amount capital currently devoted to their securities businesses by determining the amount of capital, after deductions for non-allowable assets and capital charges, that is necessary for them to have net capital in excess of the early warning level specified in Rule 17a-11.

[75] The ultimate amount would depend on the extent to which firms use models instead of standardized haircuts and the extent of any initial margin thresholds. A more detailed depiction of estimated initial margin levels is contained as Figure 1 in Appendix 2 to this letter. To create the estimates in Figure 1, we used data submitted by several SIFMA member firms in response to the Quantitative Impact Study ("**QIS**") conducted in connection with the international consultation on margin requirements for uncleared derivatives released in July 2012. Since SIFMA prepared these estimates, the results of the QIS were released as part of a second consultation. We are still studying those results. However, we note that the QIS results presented generally assume that all firms use approved internal models. Our estimates, in

Moreover, in stressed conditions, we estimate that initial margin amounts collected by firms that use internal models could increase by more than 400%. These mandatory initial margin requirements cannot be reconciled with the Commission's statutory mandate under Dodd-Frank and the Exchange Act, nor has the Commission offered a sufficient basis to justify their adoption consistent with that mandate. Indeed, in SIFMA's view, their adoption likely would substantially limit the availability of essential credit and magnify the adverse effects of financial shocks on the broader economy.

The Proposal Would Make Nonbank SBSDs Uncompetitive. It is essential, as both a statutory and a policy matter, for the Commission to take into account that bank and nonbank SBSDs are engaged in the same fundamental business – entering into SBS transactions with the same customers and in the same markets. Accordingly, while we recognize that there are relevant differences between bank and nonbank dealer business models (*e.g.*, relating to types of funding and access to backstop liquidity), it would be inconsistent with Dodd-Frank, and with preserving the competitiveness of nonbank SBSDs, to adopt capital and margin requirements that are not comparable to those of the Prudential Regulators to the maximum extent practicable.

Consistency between the Commission's and the CFTC's capital and margin requirements is also necessary for nonbank SBSDs to be competitive with bank SBSDs. Most SBSDs will also be registered as SDs. For nonbank SBSDs, this will mean compliance, at the same time, with both CFTC and Commission capital and margin requirements. Bank SBSDs, in contrast, will be subject to only to a single set of capital and margin requirements. As a result, subjecting dually registered nonbank SBSD-SDs to two sets of inconsistent capital and margin requirements would impair their ability to compete effectively, without offering any incremental safety and soundness benefits.

In addition, nonbank SBSDs compete for business with foreign SBSDs. Foreign SBSDs generally must comply with Basel-compliant capital requirements similar to those applied by the Prudential Regulators. They also will, in most cases, be subject to margin requirements that are consistent with emerging international standards. As noted above, Dodd-Frank requires the Commission to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation of SBS. We appreciate the steps the Commission has taken to satisfy this mandate through its participation as part of the Working Group on Margining Requirements of the Basel Committee on Banking Supervision ("**BCBS**") and the International Organization of Securities Commissions ("**IOSCO**" and, together with BCBS, "**BCBS/IOSCO**"). Because BCBS/IOSCO has not yet finalized its recommendations for international margin standards, however, it is not possible at this time to evaluate the extent and likely impact of any inconsistencies between the Proposal and international standards. Accordingly, we urge the Commission, once the BCBS/IOSCO recommendations are final, to re-propose its margin rules for further public comment to address any modifications that might be necessary to conform to those recommendations or to seek input on any inconsistencies between them.

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contrast, focus on a mix of model-based and haircut-based initial margin amounts. In addition, the QIS results do not take into account the increased initial margin associated with a movement from non-stressed to stressed market conditions.

The Proposal's Inconsistencies with Other Regulators' Regimes Would Increase Costs and Risks. To the extent that the Commission's requirements for dually registered SD-SBSDs apply in addition to, or in a manner inconsistent with, CFTC requirements, such requirements would exacerbate the burdens imposed by those existing requirements and tend to promote inefficiencies by discouraging dual registration. Discouraging dual registration is particularly problematic because conducting the swap and SBS dealing business in two different legal entities will reduce opportunities for netting, thereby increasing credit risk between the dealer and its customers and increasing the amount of margin required to be posted by, and the associated liquidity demands on, customers.

We see no justification, from a cost-benefit perspective, to applying inconsistent capital and margin regimes to a SBSD that is also registered as an SD, except to the minimum extent necessary to accommodate the applicable statutory regime created by Congress. Doing so would serve no purpose other than to require significant investment in the infrastructure necessary to monitor compliance with those regimes simultaneously without materially enhancing investor protection or safety and soundness.[76]

We further note that similar considerations apply in respect of other registration categories. Many SBSDs will conduct an integrated equity derivatives business, dealing in SBS and OTC options, and so accordingly will be registered as OTC derivatives dealers. For these reasons, we strongly urge the Commission to take every step possible to coordinate with the CFTC in the adoption of consistent capital and margin requirements.[77]

A More Risk-Sensitive Approach Would Better Achieve Dodd-Frank's Objectives. SIFMA has suggested below modifications to the Proposal that are intended to achieve Dodd-Frank's objectives while also addressing these considerations. In particular, we strongly urge the Commission to (i) adopt a more risk-sensitive minimum capital requirement, (ii) eliminate its proposed 100% capital deductions for collateral held by third-party custodians and undermargined legacy accounts, (iii) harmonize its liquidity stress test requirements with the applicable FRB and Basel requirements and (iv) focus on establishing a robust, two-way variation margin regime, rather than a mandatory initial margin regime.

In each case we believe that the suggested modification is both necessary and appropriate to make the relevant requirement more risk-sensitive or to prevent unintended risks and costs, to SBSDs or the financial system more generally. Moreover, we believe that the capital and margin regime, as modified to reflect our suggestions, would still ensure that nonbank SBSDs hold adequate capital (including for illiquid assets and unsecured exposures), prevent the buildup of unsecured exposures with respect to SBS, and generally reduce leverage in the financial system.

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[76] We observe that differences in the regimes applicable to bank and nonbank SBSDs raise similar issues for firms that conduct SBS activities through both bank and nonbank subsidiaries.

[77] References in this letter to stand-alone SBSDs that are approved to use internal models are also intended to apply to OTC derivatives dealers that are dually registered as SBSDs.

A summary of our specific recommendations for a more risk-sensitive approach is set forth below.

CAPITAL REQUIREMENTS

- ***Minimum Capital Requirements***. We support the Proposal's fixed dollar minimum capital requirements. However, for the adjustable minimum capital requirement, we suggest two alternative ratios to the proposed 8% margin factor that we believe will be better tailored to the actual overall risk presented by a SBSD's activities: (a) for stand-alone SBSDs that use internal models and ANC broker-dealers, a ratio based on a percentage of the entity's market and credit risk charges to capital and (b) for stand-alone and broker-dealer SBSDs that do not use internal models, a ratio based on a credit quality adjusted version of the proposed 8% margin factor.

- ***Market Risk Charges.***

    - *Adoption of Banking Agencies' Market Risk Capital Rule Revisions*. We support the incorporation of Basel 2.5 market risk standards into capital requirements for ANC broker-dealers, OTC derivatives dealers and nonbank SBSDs that use internal models, with a conforming adjustment to reflect that Basel 2.5 add-ons should not apply to assets for which the Commission already requires a firm to take a 100% haircut.

    - *VaR Model Standards and Application Process*. We request that the Commission adopt an expedited model review and approval process for models that have been approved and are subject to periodic assessment by the FRB or a qualifying foreign regulator.

    - *Standardized Market Risk Haircuts*. We suggest several modifications to the proposed standardized market risk haircuts for SBSDs that do not have approval to use internal models:

        - For cleared swaps and SBS (regardless of asset class), the capital charge should be based on the clearing organization's initial margin requirement, similar to the Commission's current treatment of futures in Appendix B of Rule 15c3-1.

        - For credit default swaps ("**CDS**"), we believe that the disparity between the proposed haircuts and capital charges derived from internal models is sufficiently wide to merit further review by the Commission of empirical data regarding the historical market volatility and losses given default associated with CDS positions.

        - For interest rate swaps, the capital charge should be calculated using solely the U.S. government securities grid, without the proposed 1% minimum haircut.

- For transactions in highly liquid currencies, the capital charge should be based on the current haircuts for similar maturity commercial paper, bankers acceptances and certificates of deposit or U.S. government securities. The capital rules also should recognize offsets between foreign exchange transactions and swaps, SBS and securities forward transactions.

- ***Credit Risk Charges.*** We recommend that, in the case of an ANC broker-dealer or a stand-alone nonbank SBSD approved to use internal models, the Commission should not limit the use of a credit risk charge in lieu of a 100% deduction for uncollateralized receivables to SBS with a commercial end user.

- ***Capital Charge In Lieu of Margin.***

  - *Third Party Custodian Deduction*. We strongly urge the Commission to eliminate its proposed 100% deduction for collateral held by a third-party custodian. Instead, the Commission should address any concerns it has regarding custodial arrangements directly through rules regarding the terms and conditions of such arrangements, for bank and nonbank SBSDs alike.

  - *Legacy Account Deduction*. We strongly urge the Commission to modify the proposed 100% deduction for undermargined legacy accounts by instead adopting either a credit risk charge or a credit concentration charge, with an exception permitting SBSDs to elect to exclude from accounts subject to the charge any currently uncleared positions in a type of SBS for which a clearing agency has made an application to the Commission to accept the SBS for clearing.

  - *Cleared SBS Deduction*. We request that the Commission eliminate the proposed 100% deduction for a shortfall between clearing agency minimum margin requirements and proprietary capital charges, and instead address any concerns regarding clearing agency minimum margin requirements directly through its regulation of clearing agencies.

- ***Liquidity Stress Test Requirements***. While we support enhancing liquidity requirements for financial institutions, we strongly urge the Commission to modify its proposed stress test requirements to align them with applicable Basel and FRB requirements, including by adopting an exception for firms subject to consolidated stress test requirements.

- ***OTC Derivatives Dealers.*** We request that the Commission modify its OTC derivatives dealer framework through conditional exemptions that would allow an OTC derivatives dealer to dually register as a stand-alone SBSD.

- ***SBS Brokerage Activities.*** A broker-dealer SBSD that is approved to use internal models should not be subject to the higher minimum capital requirements applicable to an ANC broker-dealer if it limits the scope of its brokerage activities to brokerage activity incidental to clearing SBS and accepting and sending customer orders for execution on a SBS execution facility.

MARGIN REQUIREMENTS

- ***Initial Margin Requirements.*** As noted above, mandatory initial margin requirements would replace potential exposure with actual exposure, reduce overall market liquidity, exacerbate pro-cyclical shocks and, if extended universally, place margin in the hands of entities not subject to prudential supervision. Accordingly, we strongly urge the Commission (as well as the CFTC and the Prudential Regulators) to focus on establishing a robust, two-way variation margin regime, while continuing to evaluate, in consultation with interested constituencies, including international regulators, effective methodologies to further mitigate systemic risk without causing the adverse impacts that would result from initial margin collection requirements

- ***Exceptions to the Margin Collection Requirement***. We request that the Commission make the following modifications to the exceptions to the margin collection requirement:

    - *Commercial End Users*. We request that the Commission make the definition of commercial end user for the margin exception consistent with the definition for the mandatory clearing exception, and the margin proposals of other U.S. and international regulators.

    - *Sovereign Entities*. We request that the Commission ensure that its treatment of sovereign entities is consistent with international standards.

    - *Affiliates*. We request that the Commission apply margin requirements to inter-affiliate transactions only when one of the affiliates is unregulated.

    - *Structured Finance or Securitization SPVs*. Where alternative security arrangements are in place, we request that SBS with a structured finance or securitization SPV be excluded from margin requirements. Furthermore, a SBSD's security interest in accordance with the SPV's governing documents should be considered a substitute for the collection of collateral and no capital charge for foregone margin should be required.

- ***Eligible Collateral.*** We support the Commission's proposed requirements regarding the scope of eligible collateral, except that we request that it clarify that the requirement that the SBSD maintain possession and control of the collateral should apply only to "excess securities collateral" as defined in its proposed segregation rules.

SEGREGATION REQUIREMENTS

- ***Omnibus Segregation Requirements.*** We generally support the Commission's proposed omnibus segregation requirements, but have identified a number of technical issues and questions that we believe merit further consultation by the Commission with interested constituencies.

- ***Individual Segregation Requirements.*** We request that the Commission clarify certain aspects of the individual segregation requirements, including who should receive the notice regarding the counterparty's right to elect individual segregation, the time at which a segregation election takes effect and the scope of transactions to which it applies.

- ***Segregation Requirements for Bank SBSDs***. For a SBSD that has a Prudential Regulator, we request that the Commission adopt an exception from segregation requirements, except those pertaining to the customer's right to elect individual segregation.

PHASED IMPLEMENTATION

- We request that the Commission provide a 24-month phase-in period for variation margin requirements, with a 12-month phase-in period for uncleared SBS between SBSDs.

- We also request that the Commission's proposed capital rules (other than the application of Basel 2.5) not take effect until the later of two years from the effective date of the Proposal's margin requirements or the effective date for Basel III's minimum capital requirements.

Appendix B

EXECUTIVE SUMMARY[78]

Implicit in the BCBS-IOSCO Framework is the recognition of the importance of inter- and intra-national consistency in margin requirements for non-centrally cleared derivatives ("**OTC margin requirements**"). As the Agencies consider national implementation of the BCBS-IOSCO Framework, their principal objective should be to ensure such consistency. As we explain more fully in the discussion section of this letter, to achieve that objective, and more generally to reduce systemic risk, we recommend that the Agencies take the following steps:

- **Mitigation of adverse procyclical effects**. To avoid resulting destabilizing calls for collateral during periods of extreme market stress, the Agencies should clarify that a market participant is not required, absent a direction from its prudential supervisor, to recalibrate the baseline stress scenarios and market shocks incorporated in its quantitative portfolio models based on dynamic changes in market volatilities and correlations.

- **Model approval**. To promote consistency, efficiency and transparency, the Agencies should: (a) recognize quantitative portfolio models that have been approved by home country supervisors (for firms registered in multiple jurisdictions) and consolidated supervisors (for firms subject to consolidated supervision by another regulator), in each case subject to a comparability determination; (b) permit non-registrants to use models administered by their registrant counterparties; and (c) accommodate the use of standardized models, including by non-registrants.

- **Initial margin timing requirements**. To minimize disruptive margin disputes, the Agencies should initially adopt a weekly initial margin schedule and then decrease the interval and increase the frequency of initial margin collection as portfolio reconciliation disputes are resolved more quickly and the use of standardized models becomes more widespread.

- **Consistent definitions for covered entities**. To promote international harmonization, the Agencies should (a) conform their definition of "financial entity" to the "financial counterparty" definition applicable under European rules and (b) exclude sovereign entities under a common definition of this category.

- **Structured finance/securitization SPVs**. In recognition of the appropriate alternative collateral arrangements already in place for swaps/security-based swaps with structured finance and securitization special purpose vehicles ("**SPVs**"), the Agencies should adopt an exception for non-centrally cleared swaps and security-based swaps with such entities.

- **Inter-affiliate swaps and security-based swaps**. To promote effective group-wide risk management, the Agencies should adopt an exception for non-centrally cleared swaps and security-based swaps between affiliates.

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[78] This executive summary is taken from the SIFMA Comment Letter on Margin for Uncleared Swaps at 2-4.

- **Limited "emerging market" exception**. To promote competitive parity in emerging markets while still ensuring appropriate mitigation of risk to the U.S., the Agencies should adopt an "emerging market" exception with a notional volume limitation analogous to the CFTC's exception from transaction-level requirements for foreign branches of U.S. banks.

- **Portfolio margining**. To prevent unwarranted competitive disparities between different categories of registrant, the Agencies should accommodate portfolio margining of OTC derivatives to the fullest extent contemplated by the BCBS-IOSCO Framework.

- **Eligible collateral**. The Agencies should promote international harmonization with respect to the definitions of different categories of eligible collateral assets and provide guidance on the use of industry-developed definitions for the categories of collateral assets.

- **Phased implementation**. In recognition of the dependency of implementation efforts on specific rules that have not yet been adopted (*e.g.*, definitions for covered entities, covered products, and eligible collateral), OTC margin requirements should not come into effect until two years after final rules have been adopted in the U.S., the European Union and Japan.

Appendix C

Suggested Edits to Proposed Rule 18a-1[79]

[Corresponding edits would apply to Rule 15c3-1(f)]

Additions are underlined; deletions are marked with strikethrough.

Proposed Rule 18a-1

(f) Liquidity requirements.

(1) Liquidity stress test. A security-based swap dealer that computes net capital under paragraph (a)(2) of this Rule 18a-1 must perform a liquidity stress test at least monthly, the results of which must be provided within ten business days to senior management that has responsibility to oversee risk management at the security-based swap dealer. The assumptions underlying the liquidity stress test must be reviewed at least quarterly by senior management that has responsibility to oversee risk management at the security-based swap dealer and at least annually by senior management of the security-based swap dealer. The liquidity stress test must include, at a minimum, the following assumed conditions lasting for 30 consecutive days:

(A) A stress event includes a decline in creditworthiness of the broker or dealer severe enough to trigger contractual credit-related commitment provisions of counterparty agreements;

(B) The loss of all existing unsecured funding at the earlier of its maturity or put date and an inability to acquire a material amount of new unsecured funding <u>from third parties or non-affiliates</u>~~, including intercompany advances and unfunded committed lines of credit~~;

(C) The potential for a material net loss of secured funding <u>for less liquid assets</u>;

(D) The loss of the ability to procure repurchase agreement financing for less liquid assets;

(E) The illiquidity of collateral required by and on deposit at clearing agencies or other entities which is not deducted from net worth or which is not funded by customer assets;

(F) A material increase in collateral required to be maintained at registered clearing agencies of which it is a member; and

(G) The potential for a material loss of liquidity caused by market participants exercising contractual rights and/or refusing to enter into transactions with respect to the various businesses, positions, and commitments of the security-based swap dealer, including those related to customer businesses of the security-based swap dealer.

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[79] The suggested edits to proposed Rule 18a-1 are contained in SIFMA, "SEC Liquidity Presentation" (Jan. 10, 2014), *available at:* http://www.sec.gov/comments/s7-08-12/s70812-55.pdf.

(2) Stress test of consolidated entity. The security-based swap dealer must justify and document any differences in the assumptions used in the liquidity stress test of the security-based swap dealer from those used in the liquidity stress test of the consolidated entity of which the security-based swap dealer is a part.

(3) Liquidity reserves. ~~The~~ Subject to the provisions of paragraph (f)(4) of this Rule 18a-1, the security-based swap dealer must maintain at ~~all times~~ the end of each business day liquidity reserves based on the results of the liquidity stress test. The liquidity reserves used to satisfy the liquidity stress test must be:

(A) (i) Cash, obligations of the United States, or obligations fully guaranteed as to principal and interest by the United States; and

(~~B~~ii) Unencumbered and free of any liens at all times; or

(B) Any assets that qualify as "high-quality liquid assets" in 12 C.F.R. § __.20.

Securities in the liquidity reserve can be used to meet delivery requirements as long as cash or other acceptable securities of equal or greater value are moved into the liquidity pool contemporaneously.

(4) Consolidated liquidity compliance program. A security-based swap dealer that is a consolidated subsidiary of a bank holding company that has submitted a resolution plan to the Board of Governors of the Federal Reserve System (the "Board") and the Federal Deposit Insurance Corporation (the "Corporation") during the most recent completed annual cycle, pursuant to 12 C.F.R. § 243, may apply to the Commission for approval to adopt a consolidated liquidity compliance program in lieu of maintaining the liquidity reserves that would otherwise be required by paragraph (f)(3) of this Rule 18a-1. A security-based swap dealer that has received approval from the Commission, in writing, to adopt a consolidated liquidity compliance program may maintain all or a portion of its liquidity reserves with its top-tier bank holding company [or an affiliate], as determined by the security-based swap dealer. A consolidated liquidity compliance program must ensure that the bank holding company, on a consolidated basis, complies with applicable liquidity requirements imposed by the Board and must require the bank holding company to monitor the liquidity needs of, and provide liquidity support to, the security-based swap dealer subsidiary, as necessary.

When evaluating requests under this paragraph (f)(4), the Commission shall consider:

(A) The extent to which the resolution plan anticipates the security-based swap dealer receiving liquidity support in the event of material financial distress at the bank holding company; and

(B) Whether the Board or the Corporation has objected to any relevant provision of the bank holding company's resolution plan for the most recent completed annual cycle and, if so, whether the bank holding company has resolved any such objections.

(5) Contingency funding plan. (A) The security-based swap dealer must have a written contingency funding plan that addresses the security-based swap dealer's policies and the roles and responsibilities of relevant personnel for meeting the liquidity needs of the security-based swap dealer and communications with the public and other market participants during a liquidity stress event.

(B) A security-based swap dealer that has received approval from the Commission to adopt a consolidated liquidity compliance program under paragraph (f)(4) may rely on the contingency funding plan adopted by its top-tier bank holding company rather than adopt a separate contingency funding plan under this paragraph (f)(5).

Appendix D

The following is a non-exhaustive list of places where proposed Form SBS is unclear or incomplete:

- In Part 1 of proposed Form SBS:
    - There is no reference to foreign SBSDs or MSBSPs or OTC Derivative Dealers that are dually registered as an SBSD or MSBSP.
    - It is unclear how the lines relating to "Failed to deliver," "Securities borrowed," and "Omnibus accounts" relate to security-based swaps. Are they intended to refer to securities transactions in connection with the settlement of security-based swaps, to securities that are used as collateral for security-based swaps, or to something else?
    - Receivables are broken out differently on the asset side than payables are broken out on the liability side, which results in a mismatch of entries.
    - It is unclear what "Other derivatives payables" refers to on line 23.
- In Part 2 of proposed Form SBS:
    - The referenced notes (*i.e.*, Notes B, C, and D) are not on the form;
    - The Commission does not define borrows, loans or fails on lines 7, 8, and 9, which would be helpful to ensure accurate calculation – does this refer to collateral only?
    - The security count reference on line 7 is inconsistent with proposed Rule 18a-9, which does not require a bank SBSD to conduct this count.
    - In the reserve computation section on lines 21 and 22, the reference to line 21, should be to line 20.
- In Part 4 of proposed Form SBS, which would apply to nonbank SBSDs and nonbank MSBSPs, and consists of four schedules that elicit detailed information about a firm's security-based swap and swap positions, counterparties, and exposures:
    - The Commission should clarify what "Other derivatives and options" in line 15 refers to. Is this intended to capture listed and unlisted options, or something else?
    - There is a request for information regarding "current net exposure" and "total exposure," but both requests contain columns that request information regarding "current net exposure" and "total exposure." It is unclear what information the Commission is trying to elicit from firms.

- In Part 5 of proposed Form SBS:
    - The reference to longs and shorts should be defined – is the reference to stock record, exposure, or balance sheet?

Appendix E

The following are examples of how proposed Form SBS does not adequately address the concerns of U.S. and foreign bank SBSDs and bank MSBSPs.

- Noting that banks must file financial statements and supporting schedules known as "call reports" with their prudential regulator, the Commission states that it believes that the most common form of call report for a bank that would register as an SBSD or MSBSP is Form FFIEC 031. However, banks submit a variety of call reports depending on the type of firm. For example, U.S. branches and agencies of foreign banks file Form FFIEC 002. Because the information contained on Form FFIEC 002 is not identical to Form FFIEC 031, the Commission is incorrect in assuming that banks will necessarily be able to complete Part 2 of proposed Form SBS based on "call reports." Foreign bank SBSDs and bank MSBSPs would need to generate new information to fill out Part 2 of proposed Form SBS.

- Banks are required to file call reports with their prudential regulator 30 days after the end of a quarter.[80] The Commission should modify the time period for bank SBSDs and bank MSBSPs to file proposed Form SBS to conform to the time such entities have to file their call reports.

[80] *See* Instructions for Call Report FFIEC 002 (Preparation of Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks) at Gen-1, *available at:* http://www.ffiec.gov/PDF/FFIEC_forms/FFIEC002_201403_i.pdf; Instructions for Call Reports FFIEC 031 and 041 (Preparation of Consolidated Reports of Condition and Income) at 7 (6-13), *available at:* http://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_201406_i.pdf.