

MEMORANDUM

To: File Nos. S7-05-14, S7-08-12, S7-14-15

From: Richard Gabbert, Counsel to Commissioner Hester M. Peirce

Re: Meeting with Representatives of Citigroup

On April 24, 2018, Commissioner Hester Peirce and Richard Gabbert met with the following individuals:

- Don Bendernagel (Citigroup)
- Kevin Foley (Citigroup)
- Caroline Pham (Citigroup)
- Julie Bell Lindsay (Citigroup)
- Colin Lloyd (Cleary Gottlieb Steen & Hamilton LLP)

Among the topics discussed was the implementation of various Title VII requirements applicable to participants in the security-based swap market, including security-based swap dealers.

The attached material was provided at the meeting.

Regulation of Security-Based Swaps under Title VII

April 24, 2018

Background and Objectives

- Security-based swaps (SBS) are often transacted alongside swaps by the same dealers with the same counterparties
- The CFTC, US Prudential Regulators, and foreign regulators have implemented most of their rules for swaps
- The SEC has finalized several of its SBS rules pursuant to Title VII of Dodd-Frank (e.g., SBS reporting, SBS dealer registration, SBS dealer business conduct), but certain key proposals remain outstanding (e.g., SBS dealer capital and margin, SBS dealer recordkeeping)
 - Under the SEC’s current compliance schedule, finalization of these outstanding proposals (together with a rule proposal about the process for seeking associated person disqualification waivers) will also trigger compliance dates for the other rules
- Implementing the SEC’s Title VII framework quickly, efficiently, and with minimal costs and disruption to investors will require:
 - Ensuring that the framework works cohesively with other regulators’ rules
 - Leveraging the documentation, systems, and other measures that firms have already put in place to comply with those rules
- Achieving these objectives does not require 100% harmonization with other regulators’ rules

Capital, Margin, and Segregation Requirements (Proposed Rule)

- The SEC originally proposed capital, margin, and segregation rules for SBS dealers in 2012, drawing mostly from the rules that apply to broker-dealers. For the most part, these rules would only apply to SBS dealers that are not banks (e.g., Citi's US and UK broker-dealers).
- In 2013, the Basel Committee and IOSCO adopted international standards on margin rules for non-cleared derivatives, which differ in several ways from the SEC's proposal (e.g., different method for calculating initial margin, different definitions for which counterparties are covered, different deadlines for collecting margin, inclusion of a minimum transfer amount and initial margin threshold, different segregation requirements)
- The CFTC and US Prudential Regulators adopted margin rules based on the Basel-IOSCO standards in 2015, and those rules – along with similar rules in the EU, Japan, and other key foreign jurisdictions – took effect in 2016-17
- To implement these rules, the industry developed a standard initial margin model, credit support documentation, portfolio reconciliation processes and custody arrangements

RECOMMENDATIONS: To promote US dealers' competitiveness and reduce burdens on their clients:

- Permit a foreign non-bank SBS dealer affiliate to substitute compliance with home country capital, margin, and segregation requirements if those requirements are consistent with international standards
- Permit a non-bank SBS dealer (including a broker-dealer) to portfolio margin its uncleared SBS with its uncleared swaps in accordance with CFTC margin and segregation rules, subject to appropriate conditions (including appropriately calibrated capital charges)
- Calibrate the capital charges for legacy transactions, collateral held at third-party custodians, and initial margin thresholds so that they do not make compliance with other regulators' margin rules punitive

Registration and Reporting (Final Rules); Recordkeeping (Proposed Rule)

- SEC and CFTC rules under Title VII apply extraterritorially to foreign branches, affiliates, and counterparties in ways that existing SEC rules for broker-dealers do not
 - Foreign dealers must register directly in the US, even when they trade through regulated US affiliates. Under SEC rules (but not CFTC rules), these dealers must also provide a certification and legal opinion about US access to books and records and onsite exams
 - Employees in foreign jurisdictions are subject to US regulation as associated persons, including background checks
 - Transactions between foreign dealers and foreign counterparties are subject to US reporting rules, including requirements to report identifying data regarding foreign employees and counterparties
- This extraterritorial approach creates conflicts with foreign privacy, blocking, secrecy, labor and employment laws. Without relief, dealers could not transact through their global branch networks or non-US affiliates
- The CFTC took several steps to mitigate these conflicts, including:
 - Requirements for swap dealers to notify the CFTC about foreign blocking, privacy, and secrecy laws that could impede access to records and exams, instead of requiring a certification or legal opinion about such access
 - Relief from background check requirements for associated persons located outside the US doing business solely with non-US counterparties
 - Masking relief from reporting certain identifying information covered by foreign blocking, privacy, and secrecy laws

RECOMMENDATION: Take the same steps as the CFTC or otherwise focus SBS recordkeeping and reporting rules more squarely on US-related business, so that US investors and dealers can access foreign markets effectively

Reporting (Final Rule) (cont.'d)

- The SEC's reporting rules for SBS cover most of the same data and address the same transparency objectives as the reporting rules adopted by the CFTC for swaps and reporting rules for derivatives in the EU
- But a few aspects of the SEC's rules are different from other regulators' rules in ways that will impose costs on both dealers and their clients that outstrip the benefits:
 - Requiring data repositories to disseminate trade data to the public as soon as they receive it, even if they receive it before the public dissemination deadline
 - Publicly disclosing the actual trade size, instead of partially anonymizing data through notional caps and rounding
 - For the reporting party, requiring data fields for desk ID and branch ID, in addition to counterparty ID and trader ID
 - For the non-reporting party, requiring the trade repository to solicit branch ID, broker ID, trader ID, and desk ID
 - Requiring data fields for relationship-level agreements (such as collateral agreements) other than master agreements
 - Making one of the parties responsible for reporting uncleared SBS executed on a platform, instead of making the platform responsible
 - Requiring data repositories to assign transaction IDs, instead of the reporting counterparty

RECOMMENDATION: Analyze the costs and benefits of these differences and make modifications as necessary to ensure efficient, effective and appropriately tailored regulation

- To the extent the SEC imposes different reporting obligations than other regulators, more lead time should be provided for dealers to modify their systems and educate their clients

External Business Conduct Standards (Final Rule)

- The statutory mandates for external business conduct rules are essentially identical for swaps and SBS
- The external business conduct rules finalized by the SEC in 2016 overlap extensively with the parallel rules adopted by the CFTC in 2012, but they are not identical
- Most of these differences involve slightly different wording for representations required under the rules, but these differences are not driven by different product or market characteristics for swaps vs. SBS
- The CFTC's rules have been in effect since 2013 and were implemented by the industry mainly through an ISDA Protocol containing the representations required by the CFTC's rules
 - This ISDA Protocol was developed through consultation with a wide range of stakeholders over a roughly six-month period
 - It took over nine months after ISDA published the Protocol to ensure broad, market-wide adherence
 - The Protocol now has over 20,000 adherents

RECOMMENDATION: To implement SBS external business conduct rules without disrupting investors' access to the market, provide either:

- relief that allows market participants to rely on existing ISDA Protocol representations; or
- an implementation period sufficient to launch and complete a new industry documentation initiative (e.g., 12-15 months from the date when it has finalized the open rulemakings that will trigger the SBS dealer registration requirement)

SBS Arranged, Negotiated, or Executed by US Personnel (Final Rules)

- Unlike the CFTC, the SEC has adopted final rules that will subject SBS between non-US persons to SBS dealer registration, external business conduct, and public reporting requirements if the SBS are arranged, negotiated, or executed by personnel located in a US branch or office of the SBS dealer or an agent of the SBS dealer (the “ANE” test)
- Non-US SBS dealers use US personnel to arrange, negotiate and execute SBS with non-US clients so that those clients can transact and manage risk effectively across time zones with access to the most expert personnel for the relevant asset class
- In most instances, these transactions will already be subject to US and foreign regulation:
 - The SEC will typically already oversee the US personnel because they are employed by a US broker-dealer affiliate of the non-US SBS dealer or the US branch of a bank that will register as an SBS dealer
 - Most of the non-US SBS dealers that use US personnel are subject to home country reporting, conduct of business, capital and margin rules
- Applying additional US rules to these transactions will discourage non-US clients from participating in the US market because of the burdens they will face in terms of additional documentation and duplicative public disclosure of their transactions (which could compromise anonymity)

RECOMMENDATION: Scale back or eliminate the ANE test, at least in instances where the US and foreign regulations noted above apply