April 16, 2019

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Risk Mitigation Techniques for Uncleared Security-Based Swaps; Proposed Rule - RIN 3235-AL83

Dear Mr. Fields:

The International Swaps and Derivatives Association, Inc. ("ISDA")[1] and the Securities Industry and Financial Markets Association ("SIFMA")[2](together the "Associations") appreciate the opportunity to submit these comments on the proposed rules for risk mitigation techniques for uncleared security-based swaps ("Proposal") published by the U.S. Securities and Exchange Commission ("SEC" or "Commission") on February 15, 2019.[3]

We support the Commission's efforts to finalize its Dodd-Frank Title VII rules related to security-based swaps ("SBSs") and Security-Based Swap Dealers ("SBSDs"). The Associations' members are users of SBSs, many of whom are currently provisionally registered with the U.S. Commodity Futures Trading Commission ("CFTC") as Swap Dealers ("SDs"). Thus, the Associations' comments are informed by several years of experience complying with the CFTC's rules, specifically the CFTC's risk management and documentation rules.

Overall, we commend the Commission for aligning—to a large degree—the Proposal with existing CFTC risk mitigation requirements. However, if the Commission finalizes its SBS rules as currently drafted, in a few instances, the same firms and economically indistinguishable

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 70 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and depositories, as well as law firms, accounting firms and other service providers. Additional information on ISDA is available at http://www.isda.org.

[2] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[3] *Risk Mitigation Techniques for Uncleared Security-Based Swaps*; *Proposed Rule*, 84 Fed. Reg. 4614 (Feb. 15, 2019), *available at* https://www.govinfo.gov/content/pkg/FR-2019-02-15/pdf/2018-27979.pdf.

products will be subject to similar, but not identical regulatory regimes. Disparities between the SEC and CFTC rulesets, even if minor, will lead to significant costs—particularly as it pertains to building new or modifying existing compliance systems that conform to both rulesets as well as amending existing documentation. Our comments below point to a few areas where further consistency would help mitigate unnecessary costs and related compliance burdens.

Alternatively, the SEC could consider establishing a "regulatory safe harbor," between CFTC and SEC rules, in line with its statutory exemptive authority. A regulatory safe harbor would allow firms to rely on their compliance with one agency's rules to satisfy comparable requirements set by the other agency. This approach would preserve each agency's regulatory oversight authority, while also enabling market participants to reduce the complexity and cost of complying with divergent regulatory regimes.[4] We are encouraged that, last year, the SEC adopted this approach with respect to certain external business conduct requirements for SBSDs.[5]

While a regulatory safe harbor or substituted compliance approach are available options, we strongly believe further harmonization of the SEC's rules to the existing CFTC rules is the preferred pathway forward. In this letter, we discuss how the SEC can better align its ruleset with the CFTC's rules.

Based on the foregoing, this letter addresses the topics listed below with a particular focus on areas where additional convergence could mitigate the cost and burden associated with implementing similar, but not identical rules.

- Proposed Rule 15Fi-3 (Portfolio Reconciliation)
- Proposed Rule 15Fi-4 (Portfolio Compression)
- Proposed Rule 15Fi-5 (Trading Relationship Documentation)
- Cross-Border Application of Proposed Rules 15Fi-3 through 15Fi-5; Geographic and Agency-Based Substituted Compliance

Discussion

In presenting the Proposal, the SEC notes, "divergence from [established CFTC requirements] could lead to additional costs and other inefficiencies for SBS Entities that are also registered with the CFTC as Swap Entities."[6] Not only do the Associations agree with such a statement, but we believe that avoiding such divergence should be the guiding force for the entire risk mitigation rulemaking.

[4] ISDA, along with the US Chamber of Commerce Center for Capital Markets Competitiveness, has outlined how such an approach would work in, *A Regulatory Safe Harbor for Derivatives: Ensuring a Comprehensive and Consistent US Derivatives Regulatory Framework* (Sept. 20, 2018), available at https://www.isda.org/a/cpREE/A-Regulatory-Safe-Harbor-for-Derivatives.pdf. ("Regulatory Safe Harbor Paper").

[5] Commission Statement on Certain Provisions of Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 83 Fed. Reg. 55,486 (Nov. 6, 2018), available at https://www.govinfo.gov/content/pkg/FR-2018-11-06/pdf/2018-24213.pdf.

[6] Proposal at 4619.

I. Proposed Rule 15Fi-3 (Portfolio Reconciliation)

The Associations agree that portfolio reconciliation is an important tool to resolve discrepancies regarding material terms and valuation of an SBS. We discuss where the proposed rules diverge from the CFTC's current portfolio reconciliation rule and further harmonization is necessary to reduce complexity and cost, without compromising the Commission's regulatory objective.

A. The Associations Do Not Support the Proposed Bifurcated Approach and Seek Further Clarification on "Material Terms"

Portfolio reconciliation is focused on finding discrepancies with respect to the economic terms of a trade. Portfolio reconciliation and trade reporting are two different processes involving different systems and third party vendors. Expanding portfolio reconciliation processes to include non-economic fields, as proposed in the rule, would require members to incur significant operational and technological development costs and time, with no tangible benefit for an SBSD's risk mitigation activity. Additionally, requiring reconciliation of non-economic terms for initial, but not subsequent, reconciliation exercises compounds the operational challenges. Such a bifurcated process would require further operational and technological development to manage the SBS portfolio reconciliation process over the course of the SBS life cycle events, novations, compression exercises and other events, with no apparent benefit related to an SBSD's obligation to mitigate risk.

We understand that the bifurcated process has been proposed to assist Security-Based Swap Data Repositories ("SBSDRs") with their obligation to verify with the parties to an SBS the data reported to the SBSDR. However, more clarity regarding the interaction of the SBSDR verification requirements and the suggested bifurcated portfolio reconciliation approach is necessary. For example, clarification is needed as to whether the SBSDR verification requirement specified in Section 13(n)(5)(B) of the Exchange Act will be fully met for the life of such SBS with no further verification obligations if SBSDs undertake the bifurcated portfolio reconciliation process.

In addition, we note that the verification requirement is the obligation of SBSDRs, whereas the portfolio reconciliation requirement is the obligation of SBSDs. However, the Proposal effectively imposes the verification obligation onto SBSDs. We question the suitability of this proposed shift in regulatory responsibility. We would posit it requires further analysis, including from a cost-benefit standpoint. Furthermore, if the goal of the proposed bifurcated portfolio reconciliation approach is to find a solution for SBSDRs' verification obligations involving (non-dealer) end user counterparties (which are generally not signed up as users of SBSDRs), in practice, this group of counterparties may also not be involved in meaningful portfolio reconciliation processes. Therefore, the proposed bifurcated approach, aimed at improving SBSDR verification obligations, would be of limited use and scope.

Moreover, mandating the proposed bifurcated process would impose the ongoing burden of maintaining three processes for portfolio reconciliation—one for the CFTC, a second for any SBS that has not yet been included in an SBS portfolio reconciliation, and the third for all other SBS—without providing commensurate benefit to risk mitigation. In short, we do not support the proposed bifurcated approach.

Separately, regarding the exclusion of "terms that are not relevant to the ongoing rights and obligations of the parties," the Associations urge the Commission to prescribe in the final rule those specific terms that do not need to be reconciled as done under the CFTC rule.[7] Market participants respectfully request regulatory certainty on this issue in order to avoid disputes related to regulatory obligations.[8] If the SEC does not plan to align its reporting rule with that of the CFTC, we would welcome the opportunity to work with the Commission on an enumerated list of fields that should not be included in the definition of Material Terms.

For the reasons stated above, the Associations (i) do not support the proposed bifurcated portfolio reconciliation process, (ii) request that the Commission align its trade reporting rule with that of the CFTC, and (iii) ask the Commission to prescribe an enumerated list of the "terms that are not relevant to the ongoing rights and obligations of the parties" and thus do not need to be reconciled in any portfolio reconciliation process between parties to an SBS.

B. NFA Guidance

Regarding the Commission's request for feedback whether matters from certain NFA Guidance[9] should be included in the SEC's final risk mitigation rule, the Associations agree that the portfolio reconciliation process and any reporting/notification requirements under the SEC and the respective CFTC rule should be identical. However, if the SEC were to include current NFA guidance in the final SEC rule, discrepancies could occur in the future if or when NFA guidance is updated or revised. Therefore, we suggest that the SEC put in place a process to ensure that any NFA guidance applicable to CFTC portfolio reconciliation should also apply to portfolio reconciliation for SBS, even when such guidance is updated or changed. This will help ensure that SBSDs and other entities will be able to run efficient and cost-effective portfolio reconciliations for SBSs.

II. Proposed Rule 15Fi-4 (Portfolio Compression)

We are supportive of the SEC's efforts to finalize its portfolio compression rules and align them with the CFTC's rules on portfolio compression.

A. Impact on Existing Counterparty Documentation

In the Proposal the Commission asks whether, with respect to any Swap Entity[10] that could potentially have to register as an SBS Entity,[11] the portfolio compression protocols already in

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[7] *See* 17 CFR 23.500(g).

[8] We note that full alignment between the SEC's and the CFTC's portfolio reconciliation rule will only be achieved if the fields reportable under the SEC's reporting rule and the CFTC's reporting rules are the same as this will ensure that the "Material Terms" that require portfolio reconciliation are identical under the SEC and CFTC rules. Thus, we ask the SEC to consider aligning its reporting rule with the CFTC's in order to mitigate the costs and burdens associated with complying with similar but not identical rules.

[9] *See* NFA Compliance Rule 2-49: Swap Valuation Dispute Filing Requirements; NFA Notice to Members I-17-30 (July 20, 2017), *available at* https://www.nfa.futures.org/news/newsNotice.asp?ArticleID=4827.

[10] A Swap Entity is defined as a SD or a CFTC-registered Major Swap Participant. Proposal at 4615.

[11] An SBS Entity is defined as an SBSD or a SEC-registered major security-based swap participant. Proposal at 4614.

existence for CFTC Rule 23.503 satisfy the requirements in proposed Rule 15Fi-4.[12] The documentation currently in place between market participants to address CFTC portfolio compression requirements refer to products subject to CFTC jurisdiction (not SBS) and ask whether parties are Swap Entities (and not whether they are SBS Entities). However, apart from counterparty status and applicable product scope, the industry has a strong interest in not having to address any deviations regarding the portfolio compression process (or other substantive areas covered by industry standard documentation intended to achieve compliance with CFTC swap rules) as this may trigger more detailed review, explanation and negotiation between relevant counterparties, which will be challenging, costly and time consuming without commensurate benefit to regulatory oversight.

B. Clearing Transactions

The Associations welcome the SEC's suggestion to clarify in Rule 15Fi-4(c) that portfolio compression requirements do not apply to any SBS transactions that have been cleared at any clearing house whether or not such clearing house qualifies as a "clearing agency." Clearing houses tend to have their own netting and compression practices that govern transactions cleared at their institutions. The Associations would welcome this additional language and would consider it a clarification (not a deviation from the CFTC rule).

C. "When appropriate" - Rule 15Fi-4(b)

The Associations support the addition of the words "when appropriate" in Rule 15Fi-4(b) for portfolio compression with counterparties that are not an SBS Entities. However, we ask that the SEC additionally clarify in the final rule that SBS Entities can always determine whether it is appropriate to engage in such activity.

D. Substituted Compliance

To the extent any differences remain between the SEC's and CFTC's portfolio compression rules, the SEC should allow, on an on-going basis, firms that qualify as both SBS Entities and Swap Entities to comply with proposed Rule 15Fi-4 by complying with CFTC Rule 23.503 without any further conditions.

III. Proposed Rule 15Fi-5 (Trading Relationship Documentation)

The Associations are supportive of the SEC's efforts to finalize its trading relationship documentation rules. However, like with portfolio compression, the existing protocols and documentation do not specifically refer to SBSs and SBS Entities. Market participants have a strong desire, as previously noted, to avoid having to undertake a whole new protocol which may require negotiation of different rights and obligations.

[12] Proposal at 4627.

A. Allocation of Reporting Obligations Should be Consistent with Regulation SBSR

The Proposal requires that trading relationship documentation address "applicable regulatory reporting obligations (including pursuant to Regulation SBSR) in writing."[13] We do not believe that: (i) trading relationship documentation, such as ISDA Master Agreements, including amendments effectuated by protocol or otherwise, are the appropriate place to memorialize regulatory reporting obligations; and (ii) trading relationship documentation required under the SEC's final rule should address reporting obligations that go beyond what is required under the SEC's SBS trade reporting rule ("Regulation SBSR"), for the reasons laid out in this section.

SBSR Rule 242.901 contains a reporting party hierarchy which determines which party has the reporting obligation for an SBS. Put another way, entities with the reporting obligation are the "reporting side." In many instances, such as when the parties to the trade are at different points in the hierarchy (e.g., one party is an SBSD and the other party is not a SBSD, with no SBSD involvement on its side), Regulation SBSR establishes which parties to the trade have a reporting obligation without the need for any further contractual agreement among the parties.

The proposed requirement that trading relationship documentation mirror what is already established by reporting regulation is duplicative, burdensome and will impose additional costs on SBS Entities. Additionally, it will introduce confusion to an otherwise streamlined process. For example, where the reporting party hierarchy determination under Regulation SBSR conflicts with the trading relationship documentation or if the reporting party hierarchy under Regulation SBSR changes and the trading relationship documentation between parties has not been updated accordingly.

The Associations do not believe that addressing allocation of reporting obligations in trading relationship documentation will help with the verification requirement upon SBSDRs for reported SBS data.[14] Parties to a trade are generally aware which entity (or side) has the regulatory reporting obligation—as it follows from Regulation SBSR or best practice (e.g., tie breaker logic) between the parties. Addressing this issue in trading relationship documentation adds additional burdens for SBSDs with no apparent benefit to SBSDRs verification obligation.

To the extent the parties to an SBS are at the same point in the hierarchy (e.g. both parties are SBSDs), SBSR Rule 242.901 already requires that "the sides shall select the reporting side." Regulation SBSR is not prescriptive as to how the relevant parties make such selection. Rather, in Regulation SBSR, the Commission expressed the intent to provide the parties involved with broad flexibility as to how best to agree on the selection of the reporting party. [15] Further, reporting

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[13] *Id.*

[14] *See* Section I.A of this letter related to "material terms."

[15] In the preamble to Regulation SBSR the Commission states that it "understands that, under existing industry conventions, market participants who act in a dealing capacity undertake the reporting function. Thus, the Commission believes that Rule 901(a)(2)(ii), as adopted, is not inconsistent with these current industry practices. Furthermore, the Commission would not be averse to the development and use of new or additional industry standards that create a default for which side would become the reporting side in case of a 'tie,' provided that both sides agree to use such standard." *Regulation SBSR—Reporting and Dissemination of Security-Based Swap*

obligations are often in flux —for example entities could register or de-register as SBS Entities and entities at the same level could come to new agreements as to which party shall be the reporting entity. The Proposal, if adopted as written, will have the effect of memorializing a single agreement regarding reporting obligations. Thus, introducing the additional burden of bilaterally updating trading relationship documentation every time circumstances change or new reporting rules are implemented.

This is counter to Regulation SBSR where the Commission acknowledges that some flexibility is needed in these situations to allow the relevant parties involved in the SBS to agree on the selection of the reporting side.[16] In proposing this requirement, the Commission noted that it has an interest in ensuring that reporting arrangements are "clarified in advance."[17] To address this concern, market participants that are at the same level in the reporting hierarchy and require selection of the reporting side could represent that they will report based on an industry developed tie breaker logic to be reflected in an ISDA Multilateral Agreement. The ISDA Multilateral Agreement approach is already used by industry participants for Canadian derivatives reporting and has the requisite flexibility to accommodate additional adherents, such as new entrants to the market. Utilizing an ISDA Multilateral Agreement has the dual benefit of providing the regulatory reporting obligation information the Commission seeks, while allowing the SEC to harmonize with CFTC Rule 23.504, which does not contain a comparable requirement.[18]

The Associations do not support requiring SBS trading relationship documentation to address trade reporting obligations that go beyond reporting under Rule SBSR. Multi-jurisdictional reporting requirements can change over time and include jurisdictions which do not exist today. Trading relationship documentation is certainly not the proper medium in which to notate such developments.

Notably, the proposed requirement could force institutions to "re-paper", or enter into new documentation with clients where there is potential for SBS reporting obligations to arise. It is our experience, through the implementation of other jurisdictional rules such as the CFTC documentation, risk mitigation, and business conduct rules, that such "re-papering," including amending master agreements and other trading relationship documentation, is a time-consuming and difficult process, often involving extensive bilateral negotiations.

Accordingly, the Associations believe proposed Rule 15Fi-5(b)(1) should be aligned with the CFTC's approach and ***not*** require that allocation of reporting obligations be addressed in written trading relationship documentation. Additionally, in line with the CFTC's approach, any determination as to which party reports should be addressed in the reporting rules.

Information, Final Rule, 80 Fed. Reg, 14564, 14602 (Mar. 19, 2015), available at https://www.govinfo.gov/content/pkg/FR-2015-03-19/pdf/2015-03124.pdf.

[16] *Id*.

[17] Proposal at 4628 n. 84.

[18] Proposal at 4628.

B. Auditor Requirements

With respect to audit requirement in proposed Rule 15Fi-5(c), the Associations ask the SEC to clarify that the required auditor can be "internal or external" as is the case in the CFTC rule on this matter. Audit functions can be fulfilled internally and externally and the final rule should leave no doubt that internal audits are allowed to comply with the proposed requirement.

C. Exception for Clearing Transactions

The Associations welcome the SEC's suggestion to clarify in Rule 15Fi-5(a)(1)(ii) that the SEC's trading relationship documentation requirements do not apply to any SBS transactions that have been cleared and that this exception should not be limited SBS cleared at a "clearing agency" but apply to an SBS cleared at any clearing house, regardless of registration status. The rationale for such clarification being that the relevant rules of, and agreements with, a clearing house (or clearing member) already address the terms of the cleared SBS transaction.

D. The Full Scope of the No-Action Relief Provided by CFTC Staff Letter 13-70 Should Also be Provided for Intended-to-be-Cleared ("ITBC") SBSs

The Associations note that Proposed Rule 15Fi-5 does not account for the no-action relief provided by CFTC Staff Letter 13-70.[19] The no-action letter states that the CFTC's Division of Swap Dealer and Intermediary Oversight will not recommend the CFTC commence an enforcement action against any Swap Entity that fails to comply with the requirements of the External Business Conduct Standards or CFTC Rule 23.504 with respect to an ITBC swap in several circumstances.[20]

The Proposal only provides that the trading relationship documentation rules do not apply to an SBS executed anonymously on a national securities exchange or security-based swap execution facility on the condition that it is intended to be cleared. The Associations ask that the Proposal take into account all of the scenarios provided for in CFTC Letter 13-70. Specifically, we believe that the exception for SBSs in proposed Rule 15Fi– 5(a)(1)(iii) should apply to ITBC SBSs, whether or not such instruments are executed on an anonymous basis and whether or not they are executed on a security-based swap execution facility ("SBS SEF") or national securities exchange.

Entry into an ITBC SBS is based on the counterparties' intent that such SBS will be accepted for clearing by a registered clearing agency. The terms of such a SBS may generally not contemplate, or could be different, if the SBS continues to exist despite being rejected by the clearing agency. The application of proposed Rule 15Fi-5 for non-anonymous transactions, whether or not executed on an SBS SEF, could discourage central clearing if counterparties would be required to establish trading relationship documentation for ITBC SBSs that they do not intend nor expect to ever be uncleared. An exception for ITBC SBSs would promote the clearing of SBSs and provide legal certainty to counterparties who may only intend to engage in cleared

[19] CFTC Letter No. 13-70, *No-Action Relief: Swaps Intended to be Cleared* (Nov. 15, 2013), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/13-70.pdf

[20] *Id.*

SBSs for risk management purposes or other reasons, while still achieving sound collateral and risk management practices for SBSs that exist on a bilateral basis. Such an exception would also harmonize proposed Rule 15Fi-5 with CFTC Rule 23.504 as it applies to SDs today.

IV. Cross-Border Application of Proposed Rules 15Fi-3 through 15Fi-5; Geographic and Agency-Based Substituted Compliance

The Associations agree with the SEC that any approach to substituted compliance should be outcomes-based[21] and recognize that the manner in which foreign regulators achieve compliance with G-20 commitments should be left to the front-line decision-makers (i.e., foreign regulatory authorities). Issuing comparability on a line-by-line basis, rather than focusing on outcomes, often results in regulators approving only portions of a foreign regulatory regime and attaching various conditions to such comparability, putting participants in the position of running duplicative and (in many cases) conflicting compliance programs in order to meet various U.S. and non-U.S. requirements.

The Associations believe that harmonization or a regulatory safe harbor across agencies is equally important. In this regard, we note that the CFTC has issued substituted compliance determinations to certain foreign jurisdictions' risk mitigation rules. If the SEC was to perform distinct comparability assessments and issue separate substituted compliance decisions this would result in duplicative efforts on the part of the SEC as well as additional burdens on the market participants seeking such a decision, who will also likely be registered with the CFTC as SDs. Most significantly, it would lead to either unnecessary duplication or potentially conflicting compliance programs in order to meet SEC as well as non-U.S. requirements, if the SEC were to take a different view than the CFTC.

[21] Proposal at 4639 ("Under the proposed rule, the Commission's comparability assessments associated with the portfolio compression, portfolio reconciliation, and trading relationship documentation rules accordingly will consider whether, in the Commission's view, the foreign regulatory system achieves regulatory outcomes that are comparable to the regulatory outcomes associated with those Exchange Act requirements.").

V. Conclusion

The Associations fully support the Commission's efforts to finalize its rules on SBSs and SBSDs and appreciate the opportunity to submit our comments in response to the Proposal. However, as noted in this letter, more consideration must be given with respect to any divergences in the CFTC and SEC rulesets. Every discrepancy could potentially increase compliance costs for derivatives market participants and may detract from fulfilling the goal of the rules—to mitigate risk in the derivatives markets. Therefore, complete harmonization, a regulatory safe harbor and comprehensive substituted compliance are essential tools for ensuring the SEC has oversight over the relevant market, without unduly burdening market participants.

Please contact us or Christopher Young, ISDA Head of U.S. Public Policy, [redacted], should you have any questions.

Sincerely,

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