

Ten key points from the SEC's swaps reporting and disclosure rules

On February 11, 2015, the Securities and Exchange Commission (SEC) released two final rules toward establishing a reporting and public disclosure framework for security-based swap (SBS) transaction data. The SEC's Commissioners had voted last month to approve the rules, 3 to 2.¹ These rules are the SEC's first substantive SBS requirements since the SEC began laying out its cross-border position through final rules in June 2014.² Chair White has consistently stressed the need to complete substantive SBS requirements and now appears willing to do so even when the SEC Commissioners are divided.

The SEC rules diverge from existing Commodity Futures Trading Commission (CFTC) requirements in some key ways. These divergences will create technical complexity for dealers who have built systems and processes to meet already live CFTC regulations. For example, the SEC's broader, more exhaustive, and possibly repetitive scope of "Unique Identifier Codes" (UIC) will be problematic for market participants. A less obvious problem will be the SEC's requirement to report SBS data within 24 hours (until modified by the SEC as the rule suggests), as dealers will likely want to delay public dissemination for as long as possible which will run counter to their existing set-ups for the CFTC requirement to report to a swap data repository (SDR) "as soon as technologically practicable."

- 1. The SEC's final rules leave important items unaddressed.** The final rules represent only part of the scope of upcoming reporting requirements. Chair White emphasized last month that the SEC would apply a data-driven approach going forward, in order to measure the rules' effects on trading behavior and liquidity in the market before further rulemakings. The first application of this approach appears to be the SEC's decision to defer rulemaking on block trades (and associated reporting delays) which are omitted from the final rules. Incorrectly-set block trade thresholds (or reporting timeframes) by the SEC would have adverse effects on the pricing and liquidity of the market, leading to potentially higher costs for end-users.
- 2. Market participants will seek greater clarity from the SEC in order to meet the operational burden of compliance.** A complete reporting compliance schedule and fully-defined reporting requirements for trades cleared and executed on trading platforms have only just been proposed. However, dealers are already spending significant resources to meet the trade reporting requirements of the CFTC and global regulators while fixing ongoing reporting and data quality issues. The specter of additional, but unknown, future requirements make planning problematic, as dealers will need to redirect resources to satisfy technological challenges. On the

¹ The SEC also voted last month on, and this week released, a proposed rule regarding the compliance timeline of required reporting as well as regarding reporting requirements for trades cleared and executed on trading platforms.

² See PwC's *First Take: SEC's cross-border derivatives rule* (June 27, 2014).

bright side, the SEC's proposal indicates that the eventual compliance schedule will be tied to the "registration and operational readiness" of the security-based swap data repositories (SBSDRs), which provides a degree of comfort to the industry that it will have time to test the capabilities of the SBSDRs to receive the data.

3. **The broad scope of the SEC's UICs will be problematic for dealers.** The rule requires unique identifiers for asset managers, platforms, brokers, desks, and individual traders, which is significantly more than the legal entity identifiers called for by the CFTC. Technical challenges with reporting these UICs will be further exacerbated if the SEC does not recognize a set of standards and approach to UIC construction. Otherwise, the SBSDRs will be required to define the UICs that the dealers will need to incorporate into their solutions. In our view, industry consensus on consistent UICs across SBSDRs is necessary in order to avoid confusion and additional operational burden from multiple approaches.
4. **The reporting timeframe of 24 hours grants parties a longer period to submit trade data than does the CFTC.** On first blush, providing a longer time period to submit data seems beneficial for dealers. However, the benefits to business will be hard to realize because of the complexity of treating SEC trades differently from CFTC trades, as dealers will want to wait as long as the SEC allows before reporting data. Given the SBSDR is required to disseminate any trade data immediately upon receipt, market participants treating CFTC and SEC swaps the same will be disadvantaged in hedging their SBS positions due to the price transparency, the very issue that the SEC is attempting to mitigate with this rulemaking.
5. **The SEC imposes stricter and more formal obligations on the SBSDR to define and police reporting data standards.** The SBSDRs will be required to define fields and submission formats for reported data which will assist in preventing inconsistent reporting from dealers, improving regulatory oversight, and removing uncertainty. The requirement for an SBSDR to advise reporting dealers of any gaps in any of the UIC information, on a daily basis, with the requirement for dealers to provide the missing information within 24 hours will prove problematic for dealers who have historically faced challenges with data management.
6. **Other differences between the SEC and CFTC rules will increase operational risk in the market.** For example, the absence of an SEC requirement for reporting parties to submit confirmation data and generate transaction IDs will force dealers to have a multi-faceted reporting architecture. Also, for SBSDRs, the provisions to punish individuals who mislead the Chief Compliance Officer (CCO) and to prohibit fees for data access is likely to extend the timeframes for existing repositories to achieve operational readiness. Repositories will need to update their policies and procedures to accommodate the SEC rules in areas such as these and even consider changes in business strategy.
7. **The SEC's reporting requirements apply cross-border to a larger extent than do the CFTC's.** With the SEC's cross border approach completed, but no-action relief in effect for a portion of the CFTC's cross-border rules in some jurisdictions, non-US dealers will be particularly concerned with whether or not the SEC ultimately determines that foreign reporting regimes are sufficiently comparable to the SEC's to warrant "substituted compliance." Adding even more complexity is the possibility that the SEC will make a future substituted compliance determination while the CFTC will not (or vice-versa).
8. **Future divergences from the CFTC's existing rules may cause considerable operational and compliance costs, but that does not mean the SEC will conform to the CFTC.** The SEC would prefer its own regulations, particularly in recognizing that the security-based swaps market is different from the swaps market. In instances where the policy stakes are especially high and the incremental compliance challenges are not especially heavy, the SEC is more likely to choose to go its own way. That said where divergence from the CFTC is less justified, the SEC will likely look to conform to the existing CFTC regime to avoid subjecting dealers and the marketplace to unjustifiable costs and complexity.
9. **Following the request last year from the CFTC for comment on its existing reporting rules, the industry expects the CFTC to rewrite the regulations later this year.** The industry provided commentary to both the SEC and the CFTC to align their respective reporting requirements with each other and with other global regulators. With these final SEC rules, the CFTC has greater understanding of the changes needed to align its upcoming rule rewrite with the SEC. However, it remains to be seen what compromises the CFTC will be willing to make.

10. The SEC’s adoption of the final rules over the dissent of both Republican Commissioners potentially implies stricter future rulemakings. The dissenting Commissioners’ concerns centered particularly around three points: (a) overly prescriptive corporate governance provisions; (b) a “lying to the CCO” provision that subjects individuals to legal liability (and potentially makes the job of Chief Compliance Officers more difficult by discouraging employees from communicating with CCOs); and (c) a rulemaking process where provisions were adopted at nearly the last minute and not the subject of proper notice-and-comment (as is required for SEC rules). Although it is difficult to say for sure, the changes to the final rules may suggest that a majority of the SEC, on the basis of divided votes, will end up establishing more restrictive regulations instead of taking a more intermediate approach that garners broader support within the agency.

Additional information

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