

## Press Release

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# SEC Adopts Risk Mitigation Techniques for Uncleared Security-Based Swaps

### FOR IMMEDIATE RELEASE

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Washington D.C., Dec. 18, 2019 — The Securities and Exchange Commission today voted to adopt rules requiring the application of risk mitigation techniques to portfolios of uncleared security-based swaps. New Rules 15Fi-3, 15Fi-4, and 15Fi-5 establish requirements for registered security-based swap dealers and major security-based swap participants (“SBS Entities”) to:

- Periodically reconcile outstanding security-based swaps with counterparties,
- Engage in certain forms of portfolio compression exercises, as appropriate, and
- Execute written trading relationship documentation with each of their counterparties prior to, or contemporaneously with, executing a security-based swap transaction.

These rules were adopted pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). The Commission also adopted amendments to its existing cross-border rule to provide a means to request substituted compliance with respect to the portfolio reconciliation, compression, and trading relationship documentation requirements. Finally, the Commission amended its recently-adopted recordkeeping, reporting, and notification rules to incorporate records relating to the new risk mitigation requirements.

“Ensuring that counterparties agree in writing on the terms of their security-based swap transactions, and that such transactions are periodically reconciled and compressed, goes to the heart of the Dodd-Frank Title VII regulatory regime,” said Chairman Jay Clayton. “These rules are designed to guide and drive security-based swap entities to accurately and effectively manage their market and credit risks throughout the life of a security-based swap transaction, including by mitigating the risk that a disagreement, ambiguity or omission will affect performance.”

“I again commend Commissioner Peirce for her continued leadership in our efforts to stand up the Dodd-Frank Title VII regulatory regime in coordination with our colleagues at the CFTC,” added Chairman Clayton. “I also want to thank our colleagues at the SEC, including in the Division of Trading and Markets and the Division of Economic Risk and Analysis, for bringing their considerable experience to this effort. CFTC Chairman Tarbert, former CFTC Chairman Giancarlo, Commissioner Quintenz, and CFTC staff also have my sincere thanks for engaging with us on these important rules throughout the process. I am pleased that the end result is a set of requirements that are substantially harmonized for dual SEC- and CFTC-regulated entities.”

“These rules represent an important piece of our regulatory framework for SBS Entities, as they will help ensure that the firms that play a central role in our security-based swap market are appropriately managing key risks associated with their activity in this market,” said Commissioner Hester Peirce.

“These rules codify prudent business practices that I expect most firms in our markets already follow, and, because they substantially track existing CFTC requirements, they should not impose unnecessary additional burdens on dually registered firms. I would like to thank the Commission staff in particular for

their thoughtful engagement with the concerns of market participants and with our colleagues at the CFTC.”

In a separate action today, the Commission also adopted rules and guidance addressing the cross-border application of certain security-based swap requirements, which establish the date on which SBS Entities are required to register with the Commission. Rules 15Fi-3 through 15Fi-5 complete the final set of substantive requirements applicable to those SBS Entities.

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## FACT SHEET

### Risk Mitigation Techniques for Uncleared Security-Based Swaps

December 18, 2019

#### Action

The Securities and Exchange Commission today voted to adopt new Rules 15Fi-3 through 15Fi-5 under the Securities Exchange Act of 1934 (“Exchange Act”), which require the application of specific risk mitigation techniques to portfolios of uncleared security-based swaps. Specifically, those new rules establish requirements for each registered security-based swap dealer or major security-based swap participant (collectively, an “SBS Entity”) with respect to, among other things, (1) reconciling outstanding security-based swaps with applicable counterparties on a periodic basis, (2) engaging in certain forms of portfolio compression exercises, as appropriate, and (3) executing written security-based swap trading relationship documentation with each of its counterparties prior to, or contemporaneously with, executing a security-based swap transaction.

#### Highlights

##### Rule 15Fi-3: Portfolio Reconciliation

- For purposes of the new requirements, the term “portfolio reconciliation” will be defined to mean the process by which the two parties to one or more security-based swaps:
  - Exchange the terms of all security-based swaps in the security-based swap portfolio between the counterparties;
  - Exchange each counterparty’s valuation of all outstanding security-based swaps entered into between the counterparties as of the close of business on the immediately preceding business day; and
  - Resolve any discrepancy in valuations or material terms.
  - For purposes of the above definition, the term “material terms” includes each term of a security-based swap that is required to be reported to a registered swap data repository (“SDR”) or the Commission pursuant to Regulation SBSR, other than a term that is not relevant to the ongoing rights and obligations of the parties and the valuation of the security-based swap.
  
- **Rule 15Fi-3(a)** will apply to security-based swap portfolios between two SBS Entities as follows:
  - SBS Entity counterparties will be required to engage in portfolio reconciliation no less frequently than:

- Each business day for each portfolio that includes 500 or more security-based swaps;
  - Weekly for each portfolio that includes more than 50 but fewer than 500 security-based swaps on the business day during any week; and
  - Quarterly for each portfolio that includes no more than 50 security-based swaps at any time during the calendar quarter.
  
- Any discrepancy in a material term (other than with respect to valuation) must be resolved immediately.
  
- Valuation discrepancies of ten percent or greater of the higher valuation must be resolved as soon as possible, but in any event within five business days of identifying the discrepancy.
  
- **Rule 15Fi-3(b)** will apply to security-based swap portfolios between an SBS Entity and a counterparty who is not an SBS Entity as follows:
  - The SBS Entity will be required to establish, maintain, and follow written policies and procedures reasonably designed to ensure that it engages in portfolio reconciliation no less frequently than:
    - Quarterly for each portfolio that includes more than 100 security-based swaps at any time during the calendar quarter; and
    - Annually for each portfolio that includes no more than 100 security-based swaps at any time during the calendar year.
  
  - The policies and procedures also must provide that any discrepancy in the valuation or in a material term must be resolved in a “timely fashion.”
  
- **Rule 15Fi-3(c)** establishes a reporting obligation in the event of certain unresolved security-based swap valuation disputes.
  - Specifically, an SBS Entity will be required to promptly notify the Commission of any security-based swap valuation dispute in excess of \$20,000,000, at either the transaction or portfolio level, if not resolved within:
    - Three (3) business days, if the dispute is with a counterparty that is an SBS Entity; or
    - Five (5) business days, if the dispute is with a counterparty that is not an SBS Entity.

#### Rule 15Fi-4: Portfolio Compression

- **Rule 15Fi-4(a)** will apply to security-based swap portfolios between two SBS Entities, and requires each SBS Entity to establish, maintain, and follow written policies and procedures for:

- Evaluating bilateral and multilateral portfolio compression exercises that are initiated, offered, or sponsored by any third party;
  - Periodically engaging in both bilateral portfolio compression exercises and multilateral portfolio compression exercises, in each case when appropriate, with its SBS Entity counterparties; and
  - Terminating each fully offsetting security-based swap with its SBS Entity counterparties in a timely fashion, when appropriate.
- **Rule 15Fi-4(b)** will apply to security-based swap portfolios between an SBS Entity and a counterparty who is not an SBS Entity, and require the SBS Entity to establish, maintain, and follow written policies and procedures for periodically terminating fully offsetting security-based swaps and for engaging in bilateral or multilateral portfolio compression exercises with the applicable counterparty, when appropriate and to the extent requested by any such counterparty.

#### **Rule 15Fi-5: Trading Relationship Documentation**

- **Rule 15Fi-5(a)(2)** will require each SBS Entity to establish, maintain, and follow written policies and procedures reasonably designed to ensure that it executes written security-based swap trading relationship documentation with each of its counterparties (regardless of whether the counterparty is an SBS Entity) prior to, or contemporaneously with, executing a security-based swap with such counterparty.
- Pursuant to **Rules 15Fi-5(b)(1) and (3)**, the applicable policies and procedures will need to:
  - Require that the security-based swap trading relationship documentation be in writing, and that it include all terms governing the trading relationship between the SBS Entity and its counterparty, including, without limitation, terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, governing law, valuation, and dispute resolution.
  - Require that the security-based swap trading relationship documentation include credit support arrangements addressing certain margin-related matters identified in the rule.
- **Rule 15Fi-5(b)(4)** will require that the applicable policies and procedures provide that the relevant swap trading relationship documentation between certain specified types of financial counterparties include written documentation in which the parties agree on the process, which may include any agreed upon methods, procedures, rules, and inputs, for determining the value of each security-based swap at any time from execution to the termination, maturity, or expiration of such security-based swap.
  - Such valuation methodology will be for the purposes of complying with the margin requirements under Section 15F(e) of the Exchange Act (and applicable regulations), and the risk management requirements under Section 15F(j) of the Exchange Act (and applicable regulations).

- The rule also specifies that an SBS Entity will not be required to disclose to the counterparty confidential, proprietary information about any model it may use to value a security-based swap.
- **Rules 15Fi-5(b)(5) and (6)** will require that the policies and procedures governing the applicable trading relationship documentation require SBS Entities to disclose certain information to their counterparties regarding both their legal status and the status of the security-based swap.
- **Rule 15Fi-5(c)** will require each SBS Entity to have an independent auditor conduct periodic audits sufficient to identify any material weakness in its documentation policies and procedures required by the rule.

#### Other Highlights

- The release also includes a final cross-border interpretation to treat new Rules 15Fi-3 through 15Fi-5 as entity-level requirements that apply to an SBS Entity's entire security-based swap business without exception, including in connection with any security-based swap business it conducts with foreign counterparties.
- Further, the release amends Rule 3a71-6 to address the potential availability of substituted compliance in connection with Rules 15Fi-3 through 15Fi-5.
- Finally, the release includes amendments to the recordkeeping, reporting, and notification requirements applicable to SBS Entities to require SBS Entities to make and keep records regarding portfolio reconciliation, bilateral offsets, bilateral or multilateral portfolio compression, valuation disputes, and written trading relationship documentation.

#### **Next Steps**

The rules will become effective 60 days after publication in the Federal Register. The compliance date for the new rules and rule amendments is 18 months after the effective date of the final rules and guidance addressing the cross-border application of certain security-based swap requirements, which the Commission also adopted today in a separate release.

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