

Security-based swap dealers: Preparing for trade reporting

SBSDs face the latest in a series of compliance implementation challenges.

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A key hurdle in preparing for life as a security-based swap dealer (SBSD) will be implementing operational changes and written policies and procedures to report new security-based swaps (SBS) and backload legacy trades. These requirements are included in the trade reporting regime, known as Regulation SBSR, that was recently finalized by the Securities and Exchange Commission.

Many aspects of the SEC's requirements are similar to the existing Commodity Futures Trading Commission reporting regime for swaps, but there are also a large number of differences.

In this article, the third in a series addressing the implementation tasks facing SBSBs, we look at Reg. SBSR and discuss what firms should do to get ready.

Who must report?

Reg. SBSR establishes a reporting hierarchy that dictates who will be responsible for reporting an SBS to an SBSDR—referred to as the “reporting side.” Generally, if there is an SBSB on one side of an uncleared SBS, as a counterparty or as a guarantor, the SBSB will be the reporting side. If there are SBSBs on both sides of the transaction, the parties will be required to select one SBSB to be the reporting side.

Even if an SBSB is one side to an SBS, the SBSB need not report either SBS executed on a national securities exchange or SBS execution facility—each of which referred to as a platform—that will be submitted to clearing (in which case the platform reports). An SBSB that is the reporting side of an SBS that is executed over-the-counter but submitted to clearing must report the original trade, but not the subsequent transactions between the clearing agency and its clearing members on both sides of the resulting cleared SBS—referred to as a “clearing transaction”—which is reported by the clearing agency itself.

What information must be reported?

Reg. SBSR requires certain primary and secondary trade information to be reported. Primary trade information, such as date and time of execution, price and notional amount, will be publicly disseminated by the SBSDR to which it is reported, while secondary trade information, including counterparty ID, information concerning underlying agreements for uncleared swaps, and the clearing agency (if any) to

which the trade is submitted, is not subject to public dissemination. The SEC requires reporting of certain data elements that the CFTC does not, including certain condition flags, and identifying information regarding the branch, broker, execution agent, trader and trading desk of the direct counterparty on the reporting side. (See box on page 17 for a full list of data elements and items that are required by the SEC but not the CFTC.)

Reporting sides will also need to pay close attention to the requirements to be established by SBSDRs. SBSDRs will prescribe “condition flags” that must be reported to denote important features of an SBS that, without which, may cause a distorted view of the market. In addition, SBSDRs will ultimately specify acceptable data formats and connectivity requirements.

Reporting deadlines

SBS transactions must be reported within 24 hours of execution, unless reporting would fall on a day other than a business day, in which case the SBS must be reported at the same time on the next business day after execution. This 24-hour time frame is preliminary. The SEC stated that it anticipates proposing further rulemakings relating to reporting deadlines, including whether to establish delays for block trades, after it has collected and analyzed additional data.

This provides greater leeway than CFTC rules for reporting swap transactions, which generally require that a reporting party that is a swap dealer report swap data to a swap data repository as soon as technologically practicable, but no later than 15 minutes after execution.

As under CFTC requirements, the reporting side must generally report any “life cycle” events of the SBS on a continuing basis, within 24 hours of the event. A life cycle event is one that would result in a change in the information previously reported to an SBSDR, including an assignment or novation, a change in the cash flows previously reported or a corporate action, such as a merger, dividend, stock split or bankruptcy, affecting a security underlying the reported SBS, among other things.

Reg. SBSR also imposes an “embargo rule” on SBS data. SBSBs and other persons are prohibited from disclosing, other than to the counterparty or a post-

trade processor, any information about an SBS transaction until the primary information is sent to the SBSDR. As a result, some SBSDs may at times wish to report an SBS transaction to an SBSDR in advance of the deadline.

Public dissemination

Once an SBS is reported to an SBSDR, the SBSDR must immediately publicly disseminate all primary trade information and any condition flags. However, certain information is prohibited from being publicly disseminated, including the identity of the counterparties and information relating to clearing transactions or the individual SBS resulting from the allocation of a “bunched trade.”

SBSDRs are prohibited from placing usage restrictions on or charging fees to receive or use any SBS data it is required to disseminate publicly. However, an SBSDR may impose fees on persons who are required to report transactions to the SBSDR and may also charge fees for value-added data products, provided that the SBSDR publicly disseminates the required transaction data before it makes the value-added product available.

To the extent that SBSDRs ultimately charge firms for submitting trade reports, SBSDs may need to consider whether and how to pass any such fees along to counterparties.

Historical reporting

Reg. SBSR requires that “historical SBS”—those outstanding as of July 21, 2010 or executed thereafter but before Compliance Date 1 (defined below)—be reported to the extent information is available, but information reported on these transactions will not be publicly disseminated. In addition, market participants must report life cycle events with respect to historical SBS that remain outstanding.

Inter-affiliate transactions, prime brokerage, bunched orders

Reg. SBSR contains no exception for SBS effected with affiliates. All such transactions are subject to reporting and public dissemination, except that data reported on historical inter-affiliate SBS will not be disseminated publicly.

With respect to prime brokerage transactions, each separate transaction or leg of will be subject to reporting and public dissemination. However, the SEC will expect an SBSDR to disseminate publicly conditions flags indicating that each SBS was part of a prime brokerage transaction, to ensure that market observers do not receive a distorted view of the market.

Special considerations apply to the execution and allocation of SBS initially executed as a “bunched order.” The execution of the bunched order, in its aggregate size, is subject to the same reporting and public dissemination requirements as any other SBS. However, upon allocation, the original SBS resulting from the bunched order is typically terminated and replaced by several smaller SBS between the counterparty and each party to which the SBS is allocated.

Although these allocations result in several new SBS, the allocations are subject to reporting to the SBSDR, but not public dissemination.

Additional duties

Participants of an SBSDR are generally required to provide the SBSDR with any missing information and with certain information relating to affiliates that are also participants of that SBSDR. SBSDR participants of an SBSDR must also establish, maintain and enforce written policies and procedures that are reasonably designed to ensure compliance with reporting obligations.

Cross-border rules

An SBS must be reported in accordance with Reg. SBSR and will be subject to public dissemination if there is a direct or “indirect counterparty,” such as a guarantor, that is a U.S. person on either or both sides of the SBS. However, even if the transaction is between two non-U.S. persons, the SBS will be subject to reporting and dissemination if:

- The SBS is cleared by a U.S.-based clearing agency or executed on a U.S.-based platform;
- The SBS is effected by or through a registered broker/dealer; or
- The transaction is connected with a non-U.S. person’s SBS dealing activity and is arranged, negotiated or executed by personnel of such non-U.S. person, or its agent, located in a U.S. branch or office.

If none of these conditions are triggered, but the SBS includes an SBSD on either or both sides of the SBS, the transaction must be reported to an SBSDR, but is not subject to the public dissemination requirement. If one of the direct counterparties is either a non-U.S. person or a non-U.S. branch, the reporting side may be able to satisfy its obligations under Reg. SBSR by complying with the reporting requirements of the relevant non-U.S. jurisdiction—provided that the SEC in the future makes a determination that such non-U.S. requirements are comparable to Reg. SBSR’s requirements.

Compliance date schedule

Reg. SBSR includes a compliance date schedule pursuant to which Reg. SBSR’s various requirements are phased in over time with respect to particular SBS asset classes. Market participants must begin reporting newly executed SBS in a particular asset class (Compliance Date 1) by the first Monday that is the later of:

- Six months after the date on which the first SBSDR that can accept transaction reports in that asset class registers with the SEC; or
- One month after the registration compliance date for SBSDs.

The compliance date for public dissemination requirements (Compliance Date 2) is the first Monday that is three months after Compliance Date 1. The compliance date for the reporting of historical SBS will be two months after Compliance Date 2.

Use of publicly disseminated SBS data

While not specifically mandated in Reg. SBSR, SBSDs will need to consider what use to make of public SBS data in connection with their transaction pricing and reviews of customer transactions. Such data may also be relevant to firms' risk management and position marking procedures. This type of information is wide-

ly used for such purposes by dealers in other markets, such as equities, fixed income and listed options.

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Compliance Checklist: What should firms be doing now?

- Prepare policies and procedures reasonably designed to ensure compliance with reporting obligations.
- Develop, or leverage existing, systems designed to capture the data elements that are required to be reported and ensure such systems are capable of reporting this information within the required timeframes.
- Identify and collect available data for historical SBS.
- Establish controls to embargo information regarding an SBS until the data is reported to an SBSDR.
- Monitor rules and technical specifications promulgated by SBSDRs, including with respect to condition flags, and incorporate into operational processes and policies and procedures.
- Consider whether and how to incorporate data to be disseminated by SBSDRs into various processes, including compliance reviews
- Non-U.S. SBSDs should consider whether: (i) it would be appropriate to apply for substituted compliance and gather, or assist others in gathering, the necessary materials to apply for the substituted compliance determination; and (ii) any applicable foreign legal regimes will preclude reporting of any required data elements and develop a strategy for addressing any such restrictions.



Data to be reported

The reporting side must provide the following information to an SBSDR. Items with an * indicate that an equivalent data element is not required under CFTC reporting requirements for swaps.

Primary trade information, which includes the following:

- Contractual terms, which are generally reported either as a standardized product identifier, if available, or by reporting specific terms such as the asset class of the SBS, its underlying reference asset(s), the effective and scheduled termination dates and the terms of any fixed or floating leg
- Date and time, to the second, of execution
- Price
- Notional amount and relevant currency
- If both sides of the SBS include a registered SBSD, an indication to that effect
- Whether the SBS is intended to be submitted to clearing
- Any condition flags of the SBSDR, if applicable*

Secondary trade information, which includes the following:

- Counterparty identification or execution agent ID about each counterparty
- Branch ID, broker ID, execution agent ID, trader ID and trading desk ID, as applicable, of the direct counterparty on the reporting side*
- Any payment terms not reported as primary trade information
- For non-clearing transactions, the title and date of any agreements incorporated into the terms of the SBS, such as master agreements and collateral agreements*
- Any data elements, not otherwise reported, necessary for a person to determine the market value of the transaction
- Names of the relevant clearing agency to which the SBS will be submitted, if applicable
- If the SBS will not be cleared, whether the counterparties have invoked a statutory clearing exception
- If not submitted to clearing, a description of the settlement terms, such as cash-settled
- Platform ID, if applicable
- If the SBS arises from the allocation, termination, novation, or assignment of one or more existing SBS, the transaction ID of the original SBS