



Commodity Futures Trading Commission

Office of Public Affairs

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Proposed Rule on Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants

The Commodity Futures Trading Commission (Commission) is proposing regulations establishing requirements for swap confirmation, portfolio reconciliation and portfolio compression for swap dealers and major swap participants.

Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

Section 731 of the Dodd-Frank Act amends the Commodity Exchange Act (CEA) by adding section 4s, which sets forth a number of requirements for swap dealers and major swap participants. This rulemaking is being proposed pursuant to section 4s(i). Section 4s(i)(1) requires swap dealers and major swap participants to “conform with such standards as may be prescribed by the Commission by rule or regulation that relate to the timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps.” Section 4s(i)(2) expressly directs the Commission to “adopt rules governing documentation standards for swap dealers and major swap participants.”

The proposed regulations would require swap dealers and major swap participants to adhere to certain standards for the timely and accurate confirmation of swaps transactions and would require the reconciliation and compression of swap portfolios. Confirmation, portfolio reconciliation, and portfolio compression have been recognized as important post-trade processing mechanisms for reducing risk and improving operational efficiency. The specific confirmation, reconciliation, and compression obligations required by the proposed regulations would vary, depending upon whether the particular swaps transaction or portfolio is between a swap dealer and major swap participant, or involves other types of counterparties. The Commission will propose additional rules related to the documentation provisions under section 4s(i) in the coming weeks.

Proposed Confirmation Rules

The proposed regulations would require each swap dealer and major swap participant that enters into a swap transaction with another swap dealer or major swap participant to execute a confirmation for the swap transaction on the same calendar day as execution. The times prescribed for achieving swap confirmation would vary, depending upon whether the swap transaction is electronically executed or electronically processed.

A swap dealer or major swap participant that enters into a swap transaction with a counterparty other than a swap dealer or major swap participant would be required to send an acknowledgement of the swap transaction on the same day as execution. It also would be required to have policies and procedures in place to confirm the swap transaction on the same calendar day as execution for financial entities, as defined in section 2h(7)(c) of the CEA, and on the next business day for all other counterparties. The procedures would have to include an obligation to furnish to, or receive from, its prospective counterparty, a draft acknowledgement specifying the terms of the swap transaction (other than pricing and the terms to be definitively agreed to at execution), prior to execution.

The swap transactions to which the acknowledgement and confirmation requirements apply would be defined to include all events that would result in a new swap or in a change in the terms of a swap. Such events would include execution as well as various ownership actions that might occur during the life cycle of the swap, such as termination prior to the scheduled maturity date or the assignment, novation, exchange, transfer, amendment, conveyance, or extinguishing of the rights or obligations of the swap. Both the acknowledgements and the confirmations required by the proposed regulations would, by definition, be required to include all of the terms of the swap transaction.

Finally, a swap dealer or major swap participant would be required to make and maintain certain records of the required acknowledgements and confirmations.

Proposed Portfolio Reconciliation Rule

The proposed regulations would require swap dealers and major swap participants to engage in portfolio reconciliation with respect to swap transactions, other than those that are cleared by a derivatives clearing organization. The required portfolio reconciliations could be performed bilaterally by the counterparties or by qualified third parties, and the counterparties would be required to agree, in writing, to the terms of the reconciliation.

Swap dealers and major swap participants would be required to reconcile swap portfolios with other swap dealers or major swap participants daily, weekly, or quarterly, depending upon the size of the particular swap portfolio. Discrepancies in material terms identified as part of a portfolio reconciliation process would be required to be resolved immediately. Discrepancies in valuation would be required to be resolved within one business day, if the difference between the lower valuation and the higher valuation is less than 10% of the higher valuation. The proposed regulations would not prescribe any specific procedures that must be followed to resolve a discrepancy in valuation.

For swap portfolios involving a counterparty that is not a swap dealer or major swap participant, the proposed regulations would require that swap dealers and major swap participants establish written policies and procedures to perform portfolio reconciliation. The frequency parameters of the portfolio reconciliation process would be similar to the frequency requirements for swap portfolios between swap dealers and major swap participants. The proposed regulations would not, however, prescribe deadlines for the resolution of discrepancies in the material terms or valuation of swaps. Instead, swap dealers and major swap participants would be required simply to establish written procedures that are reasonably designed to resolve identified discrepancies in a timely fashion.

Finally, the proposed regulations would require that swap dealers and major swap participants retain records of each discrepancy identified during portfolio reconciliation that is not resolved within one business day.

Proposed Portfolio Compression Rule

The proposed regulations would establish certain offset and portfolio compression requirements and related recordkeeping obligations for swap dealers and major swap participants with respect to swaps in which their counterparty is also a swap dealer or major swap participant.

Specifically, swap dealers and major swap participants would be required to participate in multilateral portfolio compression exercises required by Commission regulation or order or offered by a derivatives clearing organization, a self-regulatory organization, or a self-regulatory association of which the swap dealer or major swap participant is a member, to the extent their swap transactions are eligible for compression. Specific swaps could be excluded from a portfolio compression exercise, if including the swaps would be likely to increase the risk exposure of the swap dealer or major swap participant. Swap dealers and major swap participants also would be permitted to establish counterparty, market, cash payment, and other risk tolerances and to exclude potential counterparties from compression exercises, provided that risk tolerances or counterparty exclusions are not used to evade the compression requirements.

Swap dealers and major swap participants also would be required to terminate bilaterally all fully offsetting swaps between them within one day and to engage annually in bilateral portfolio compression exercises with counterparties that are also swap dealers or major swap participants, except to the extent that the counterparties have mutually participated in a multilateral exercise involving the swaps between them during the same year.

The proposed regulation would not mandate portfolio compression exercises for swaps between a swap dealer or a major swap participant and other types of counterparties. Instead, swap dealers and major swap participants would be required to maintain written policies and procedures for periodically terminating any fully offsetting swaps and for periodically engaging in compression exercises, to the extent that the swaps are able to be terminated through compression.