

# Additional Verification Required: CFTC Proposes Enhanced Swap Data Verification Requirements

May 16, 2019

On April 25, 2019, the Commodity Futures Trading Commission (the “CFTC”) proposed amendments to its regulations governing swap data repositories (“SDRs”), including regulations affecting the data reported to and maintained by SDRs.<sup>1</sup>

This proposed rulemaking (the “**Proposal**”) is the first of the three rulemakings the CFTC is expected to release related to its 2017 Roadmap to Achieve High Quality Swaps Data<sup>2</sup> and the associated comprehensive review of, and solicitation of comments regarding,<sup>3</sup> the CFTC swap data reporting rules and swap reporting requirements.<sup>4</sup> This Proposal is generally focused on amendments to regulations affecting SDRs, but would also impose significant new obligations upon the party to a swap transaction (a “**reporting counterparty**” or “**RCP**”) responsible for reporting specified information (“**Swap Data**”) regarding the transaction to an SDR. Such obligations include regular reconciliation and verification of the completeness and accuracy of Swap Data (including all data fields) for the RCP’s open swaps and prompt correction of errors and omissions, including for swaps that have expired or been terminated.

The following Memorandum provides a brief overview of the applicable regulations to SDRs and RCPs, with particular focus on how the Proposal, if finalized, would alter an RCP’s obligations.

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<sup>1</sup> *Proposed Amendments to the Commission’s Regulations Relating to Certain Swap Data Repository and Data Reporting Requirements* (Apr. 25, 2019) [hereinafter Proposal],

[https://www.cftc.gov/system/files/2019/04/25/federalregister042519.pdf?utm\\_source=govdelivery](https://www.cftc.gov/system/files/2019/04/25/federalregister042519.pdf?utm_source=govdelivery).

<sup>2</sup> *Roadmap to Achieve High Quality Swaps Data* (July 10, 2017),

[https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/dmo\\_swapdataplan071017.pdf](https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/dmo_swapdataplan071017.pdf).

<sup>3</sup> CFTC Letter No. 17-33 (July 10, 2017).

<sup>4</sup> Proposal, at 8–9. The CFTC plans to re-open the comment period for this Proposal once the CFTC releases the other two proposed rulemakings. *Id.* at 9.



## **Background**

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) called for the creation of SDRs and required that all swaps be reported to an SDR.<sup>5</sup> Dodd-Frank prescribed the duties of an SDR, including obligations to accept Swap Data, confirm the accuracy of submitted Swap Data with swap counterparties, and maintain Swap Data in a manner that provides electronic access to the CFTC. The CFTC also promulgated rules regarding registration, governance, and conduct of SDRs, including with respect to the acceptance and maintenance of Swap Data and the related responsibilities of parties to swap transactions.<sup>6</sup>

## **Current Swap Data Verification and Correction Requirements**

Current CFTC rules require verification and correction of Swap Data, although the manner in which an SDR must verify such data’s accuracy is largely dependent on the SDR’s policies and procedures, and varies depending on the type of entity submitting the Swap Data to the SDR.

### *1. Direct Submission by RCP*

If an RCP directly submits Swap Data to an SDR, the SDR must verify that Swap Data by (1) notifying both counterparties to the underlying swap transaction and (2) receiving back from both counterparties (a) an acknowledgement that such data is accurate or (b) a notification that such data is inaccurate together with corrected Swap Data; however, if the counterparties do not respond, an SDR may presume that the Swap Data sent to the counterparties is accurate.<sup>7</sup>

### *2. Submission by Non-RCPs*

If an RCP does not submit Swap Data directly to the SDR, and the data is instead submitted by a swap

execution facility (a “SEF”), designated contract market (a “DCM”), derivatives clearing organization (a “DCO”), or third-party service provider who is acting on behalf of an RCP, an SDR may verify the Swap Data without any additional action if the SDR: (1) reasonably believes the Swap Data is accurate; (2) the Swap Data suggests that both counterparties agreed to the data; and (3) the SDR provides “both counterparties with a 48 hour correction period after which a counterparty is assumed to have acknowledged the accuracy of the swap data.”<sup>8</sup>

### *3. Correction of Errors or Omissions*

Should any registered entity or RCP who is required to report Swap Data discover that Swap Data it has reported is incorrect, then it must provide the SDR the correct data “as soon as technologically practicable.”<sup>9</sup> Should a non-RCP discover that Swap Data reported for one of its swaps is incorrect, it must promptly notify the RCP for such swap so the RCP can correct the Swap Data.

Taken together, current verification rules do not generally require additional steps to be taken by RCPs, SEFs, DCMs, DCOs, or SDRs. Instead, Swap Data is assumed to be verified absent reason to believe that there may be an error in submitted Swap Data (or the discovery of an actual error in the Swap Data).

## **Proposed Swap Data Verification and Correction Requirements**

The Proposal, if finalized, would impose significant new obligations upon SDRs and RCPs related to verifying and correcting Swap Data. Most notably, the Proposal would: (1) impose additional verification responsibilities for Swap Data on RCPs,

<sup>5</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 727-28, 124 Stat. 1376 (2010); 7 U.S.C. §§ 2(13)(G), 24a.

<sup>6</sup> Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136 (Jan. 13, 2012); Swap Data Repositories: Registration Standards, Duties and Core Principles, 76 Fed.

Reg. 54538 (Sep. 1, 2011) [hereinafter Swap Data Repositories].

<sup>7</sup> Swap Data Repositories, 76 Fed. Reg. at 54545–46; Proposal, at 34.

<sup>8</sup> Swap Data Repositories, 76 Fed. Reg. at 54545–46.

<sup>9</sup> Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. at 2170.

regardless of whether an SDR received such data directly from the RCP or a third party; (2) set out a new process through which RCPs and SDRs ensure that the Swap Data maintained by SDRs is accurate; and (3) amend the process through which parties correct Swap Data errors or omissions outside of the regular verification process.

### *1. Additional Swap Data Verification Responsibilities for RCPs*

The Proposal would add a general requirement for an RCP to verify the accuracy and completeness of Swap Data.<sup>10</sup> This new requirement would affect RCPs in two ways once Swap Data has been submitted to an SDR. First, under the Proposal, an RCP would be required to help an SDR verify Swap Data for any “open swap” for which it is designated as the RCP, regardless of how the Swap Data is reported to the SDR.<sup>11</sup> This change would eliminate the current exception from counterparty verification for Swap Data submitted by a SEF, DCM, DCO, or third-party service provider on the RCP’s behalf. Second, unlike current CFTC rules, an RCP would be required to affirmatively respond to an SDR’s request for the RCP to verify the accuracy of the Swap Data.<sup>12</sup>

In her concurrence to the Proposal, Commissioner Dawn Stump questioned whether the benefit of this additional verification requirement outweighed the associated compliance burdens, noting that it is unclear whether the minimal amount of Swap Data that is actually incorrect is sufficient to justify

imposing these obligations upon RCPs.<sup>13</sup> Commissioner Stump also questioned the elimination of the distinction between treatment of data submitted directly by an RCP and data submitted by a SEF, DCM, DCO, or third-party service provider when the latter sources are widely considered to be trusted sources. In this regard, current operational processes place limits on RCPs’ ability to correct data submitted by certain trusted third parties.

### *2. New Swap Data Verification Process*

As noted above, SDRs currently have discretion regarding the policies and procedures they use to verify the accuracy of Swap Data. The Proposal would restrict this discretion by regulating the following multi-step Swap Data verification process.<sup>14</sup>

- First, an SDR would regularly distribute an “open swaps report” to each party designated as an RCP for each open swap on which the SDR maintains Swap Data.<sup>15</sup> An RCP who is a registered swap dealer (“SD”), major swap participant (“MSP”), or DCO would receive this report weekly, while all other RCPs would receive this report monthly.
- Second, once an SDR distributes the open swaps report, an RCP receiving it would reconcile the report with its internal books and records for each open swap for which it is the RCP to verify the accuracy of the Swap Data, including all data fields.<sup>16</sup>

<sup>10</sup> Proposal, at 97.

<sup>11</sup> *Id.* at 97. The Proposal defines an “open swap” as an executed swap which has not matured, closed out, terminated, or been settled. *Id.* at 13.

<sup>12</sup> *Id.* at 37.

<sup>13</sup> See Statement of Concurrence of Commissioner Dawn D. Stump on Proposed Rule Amendments to The Commission’s Regulations Relating to Certain Swap Data Repository and Data Reporting Requirements, CFTC (Apr. 25, 2019) [hereinafter Commissioner Stump Concurrence], [https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement042519?utm\\_source=govdelivery](https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement042519?utm_source=govdelivery).

<sup>14</sup> Proposal, at 37–45.

<sup>15</sup> *Id.* at 38–39, 41–42. SDRs could comply with this proposed requirement by either sending RCPs an open swaps making the open swaps data accessible to RCPs. *Id.* If all swaps for which an entity was the RCP were terminated before the SDR begins compiling an open swaps report, the SDR would not need to provide an open swaps report to that RCP.

<sup>16</sup> *Id.* at 97. The SDR must follow the confidentiality requirements in the CFTC’s regulations when preparing open swaps reports, such as the requirement to keep the non-RCP’s identity anonymous if the applicable swap was executed anonymously on a SEF or DCM and cleared. *Id.* at 40 n.88. The CFTC also requests comment regarding

- Third, the RCP would report the results of this comparison back to the SDR. This report would be “either a verification of data accuracy,” noting that the Swap Data is accurate, or “a notice of discrepancy,” noting that the Swap Data is incorrect for some reason and providing the accurate data.<sup>17</sup> An RCP who is an SD, MSP, or DCO would have to provide a response for each of its applicable swaps within forty-eight hours of receiving the open swaps report, while all other RCPs would have to provide a response within ninety-six hours. Notably, an RCP would submit a verification of data accuracy or notice of discrepancy to an SDR that maintains the RCP’s Swap Data in *all* circumstances for *all* of the open swaps for which it is the RCP, even if the RCP believes: (1) all of the Swap Data included in the report is accurate; (2) it received the report in error; or (3) it did not receive a report from an SDR when it should have. The RCP would submit a verification of data accuracy or notice of discrepancy in accordance with the SDR’s policies and procedures, which the SDR is required to disclose to SEFs, DCMs, and RCPs.

This process differs materially from the Securities and Exchange Commission’s (the “SEC’s”) approach to data verification for security-based swaps. The SEC would allow (1) an SDR to satisfy its Swap Data verification requirements by reasonably relying on data submitted by certain third parties and (2) a reporting security-based SD to use the SEC-mandated portfolio reconciliation process to satisfy its verification requirements.<sup>18</sup>

Commissioner Stump stated in her concurrence that the CFTC should avoid becoming out of sync with the SEC on this issue. In addition, because SDs already must check the accuracy of

their portfolios through CFTC-mandated reconciliation exercises and report almost all swaps, Commissioner Stump suggested that the CFTC, like the SEC, should permit SDs to verify their Swap Data by sending to the applicable SDRs the results of such exercises.<sup>19</sup>

This proposed Swap Data verification process would represent a significant compliance challenge for RCPs. Certain RCPs, especially those which are not SDs, may not have swap data reconciliation or verification systems. Commissioner Stump noted this compliance challenge would be especially difficult for end-user RCPs and requested comment on how this process should be changed for end-user RCPs to reflect this difficulty. Commissioner Stump also specifically requested that commenters address whether applying the Swap Data verification requirements to a subset of swaps or Swap Data would provide sufficient benefit while imposing a smaller compliance burden.

### 3. *Correcting Swap Data Outside of the Proposed Verification Procedures*

The Proposal would change the applicable standard for identification of errors or omissions in Swap Data and the associated procedures for when an RCP, or any third party, that reported Swap Data must correct such errors or omissions.

#### (a) Proposed Standard for Correcting Swap Data

The proposed Swap Data correction standard would require a SEF, DCM, or RCP to correct Swap Data when it “by any means becomes aware of any error or omission in swap data previously reported to

whether RCPs should be required to verify all Swap Data messages, not just open swaps reports.

<sup>17</sup> *Id.*

<sup>18</sup> SEC, Risk Mitigation Techniques for Uncleared Security-Based Swaps, 84 Fed. Reg. 4614, 4633–34 (Feb. 15, 2019).

<sup>19</sup> Commissioner Stump Concurrence, *supra* note 13. Notably, however, the SEC’s proposed portfolio reconciliation rules would require reconciliation of all the data reported under SEC Regulation SBSR, whereas the CFTC’s corollary rules only require reconciliation of certain material terms.

an SDR.”<sup>20</sup> This standard is effectively the same as the current standard, but would clarify which entities have the correction reporting responsibilities by specifically identifying that the obligation applies to any SEF, DCM, or RCP who previously reported the Swap Data to the SDR. The Proposal specifically notes that this correction standard is triggered when a SEF, DCM, or RCP becomes aware that certain Swap Data should have been reported but was not.<sup>21</sup> The proposed changes to this standard would apply not only to the creation and continuation Swap Data the CFTC requires to be reported to SDRs under Part 45 but also to the swap transaction and pricing information the CFTC requires to be reported to SDRs in real-time under Part 43. Both over-reporting and under-reporting would need to be corrected.

#### (b) Proposed Scope and Timing of Swap Data Correction Requirement

Unlike current CFTC rules, the Proposal explicitly states that this correction standard applies to all swaps, “regardless of the state of the swap that is the subject of the swap data.”<sup>22</sup> In addition, instead of submitting Swap Data corrections only “as soon as technologically practicable” after discovering Swap Data errors, the Proposal “backstops” this standard by requiring parties to submit such corrections within three business days or otherwise notify CFTC staff of the errors or omissions, how it plans to correct such errors or omissions, and certain details regarding the swaps (*e.g.*, their unique swap identifiers and date range).

Commissioner Stump, in her concurrence, questioned the need for correcting data on expired or “dead” swaps and whether compliance costs outweighed the value of this

information. The Proposal’s rationale for applying this standard to such swaps is that this data is needed for the CFTC’s ability to analyze the swaps market when fulfilling its regulatory responsibilities and that doing so would encourage RCPs to establish more effective reporting systems to prevent errors or omissions.

#### 4. Standard for Compliance

In addition to proposing changes to the Swap Data verification and correction regulations, the Proposal introduces a new standard for compliance with these regulations. Specifically, it imposes a reasonableness standard for identifying errors or omissions in Swap Data maintained by SDRs. As result, a party that failed to discover an error it should have reasonably discovered and corrected, and thereby verified erroneous Swap Data, would violate the CFTC’s rules.<sup>23</sup>

The Proposal also noted RCPs repeatedly identifying that their Swap Data is incorrect in the open swaps reports could result in non-compliance with these rules. Should such repeated discoveries occur, the CFTC expects that the applicable RCP would remediate its reporting systems or risk non-compliance.<sup>24</sup>

Swap data reporting deficiencies has been a notable area of enforcement focus by the CFTC, as the CFTC has in the past two years ordered multiple parties to pay civil penalties in connection with the parties’ failure to report Swap Data to SDRs.<sup>25</sup>

<sup>20</sup> Proposal, at 102, 104.

<sup>21</sup> *Id.* at 102 n.184.

<sup>22</sup> *Id.* at 105. The CFTC “does not believe this is a new requirement, as the current correction requirements . . . do not have time restrictions.” *Id.*

<sup>23</sup> *Id.* at 101.

<sup>24</sup> *Id.*

<sup>25</sup> See, *e.g.*, *CFTC Orders Commerzbank AG to Pay \$12 Million for Swap Dealing Violations and for Misleading Statements to the CFTC* (Nov. 8, 2018), <https://www.cftc.gov/PressRoom/PressReleases/7837-18>; *CFTC Settles Swap Reporting Charges with Natwest Markets Plc* (Sep. 14, 2018), <https://www.cftc.gov/PressRoom/PressReleases/7788-18>; *CFTC Orders Cargill, Inc. to Pay a \$10 Million Civil*



### 5. *New Reporting Policies and Procedures*

The Proposal would require that SDs and MSPs establish, maintain, and enforce written policies and procedures reasonably designed to ensure compliance with their Swap Data reporting obligations under Parts 43 and 45 of the CFTC's rules.<sup>26</sup> Such policies and procedures would need to address: (1) the reporting process and designation of responsibility for reporting Swap Data; (2) reporting system outages and malfunctions, and when and how back-up systems are to be used in connection with required reporting; (3) verification of all open swaps reports to an SDR in accordance with the policies and procedures of such SDR; (4) a training program for employees responsible for Swap Data reporting; (5) control procedures relating to Swap Data reporting and designation of personnel responsible for testing and verifying such policies and procedures, (6) review and assessment of the performance and operational capability of any third party that carries out reporting duties on behalf of the SD or MSP; and (7) for real-time public reporting, the determination of whether a new swap transaction or amendment, cancelation, novation, termination, or other life cycle event is subject to real-time public reporting.<sup>27</sup> An SD or MSP would be required to review these policies and procedures annually and update them as needed.

SDs and MSPs are already subject to requirements to maintain policies and procedures reasonably designed to ensure compliance with the CEA and CFTC regulations, including Parts 43 and 45, but these new requirements are more prescriptive

regarding the content and frequency of review of those pre-existing policies. The CFTC also noted in the Proposal that the SEC has adopted similar requirements, such that the Proposal would serve to harmonize the respective rules.

### **Other Key Proposals Affecting SDRs**

In addition to the issues addressed above, the Proposal would amend a number of Swap Data verification and recordkeeping requirements applicable to SDRs that would affect the governance and operation of SDRs. These amendments generally mirror or operate in conjunction with the proposed Swap Data verification and correction requirements for RCPs and third parties who report Swap Data to SDRs. Among these amendments, the Proposal would require an SDR to:

- generally “verify the accuracy and completeness” of the Swap Data it receives;
- work in conjunction with RCPs to verify Swap Data that the SDR maintains by regularly distributing open swaps reports to RCPs, even if such RCPs did not directly submit the Swap Data;
- create and maintain policies and procedures for RCPs to follow when they provide their required responses to the open swaps reports and to edit Swap Data based on such responses;
- maintain all Swap Data and any related communications, including records of data reporting errors, in a readily accessible manner throughout the swap's duration and five years thereafter, and then maintain such

*Monetary Penalty for Providing Inaccurate Mid-Market Marks on Swaps, Which Concealed Cargill's Full Mark-up, in Violation of Swap Dealer Business Conduct and Reporting Requirements, and for Failing to Supervise Swap Dealer Employees* (Nov. 6, 2017), <https://www.cftc.gov/PressRoom/PressReleases/pr7640-17>; *CFTC Orders Citibank, N.A. and London-based Citigroup Global Markets Limited to Pay a \$550,000 Penalty for Swap Data Reporting Violations Involving Legal Entity Identifier*

*Information and Related Supervision Failures* (Sep. 25, 2017), <https://www.cftc.gov/PressRoom/PressReleases/pr7616-17>.

<sup>26</sup> Proposal, at 118–22.

<sup>27</sup> *Id.* at 119, 121–22. The Proposal also states that an SD's or MSP's know-your-counterparty policies and procedures should address information, such as counterparty LEI and U.S. person status, necessary to satisfy reporting obligations. *Id.* at 120.

information in archival storage for at least ten years thereafter;

- establish automated systems that monitor, screen, and analyze Swap Data upon the CFTC's request and provide reports from such activity to the CFTC regarding certain information, such as market participant swap positions and swap counterparty exposure;
- maintain all Swap Data and related communications in a format acceptable to the CFTC and provide all such data to the CFTC in a format acceptable to the CFTC upon the CFTC's request; and
- through their chief compliance officer, take "reasonable steps" to resolve any "material" conflicts of interest that arise.<sup>28</sup>

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<sup>28</sup> *Id.* at 32–74.