Federal Register on November 23, 2010 (75 FR 71379), and as proposed to be amended elsewhere in this issue of the **Federal Register**, as follows:

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

1. The authority citation for part 23 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b-1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

2. Amend proposed § 23.504 by adding paragraph (b)(5) to read as follows:

§ 23.504 Swap trading relationship documentation.

* * * * *

(b) * * *

(5) The swap trading relationship documentation shall include written documentation in which the counterparties agree that in the event a counterparty is a covered financial company (as defined in section 201(a)(8) of the Dodd-Frank Wall Street Reform and Consumer Protection Act) or an insured depository institution (as defined in 12 U.S.C. 1813) for which the Federal Deposit Insurance Corporation (FDIC) has been appointed as a receiver (the "covered party"):

(i) The counterparty that is not the covered party may not exercise any right that such counterparty that is not the covered party has to terminate, liquidate, or net any swap solely by reason of the appointment of the FDIC as receiver for the covered party (or the insolvency or financial condition of the covered party):

(A) Until 5 p.m. (U.S. eastern time) on the business day following the date of the such appointment; or

(B) After the counterparty that is not the covered party has received notice that the swap has been transferred pursuant to section 210(c)(9)(A) of the Dodd-Frank Wall Street Reform and Consumer Protection Act or 12 U.S.C. 1821(e)(9)(A);

(ii) A transfer pursuant to section 210(c)(9)(A) of the Dodd-Frank Wall Street Reform and Consumer Protection Act or 12 U.S.C. 1821(e)(9)(A) may include:

(A) All swaps between a counterparty that is not a covered party, or any affiliate of such counterparty that is not a covered party, and the covered party;

(B) All claims of a counterparty that is not a covered party, or any affiliate of such counterparty that is not a covered party, against the covered party under any such swap (other than any claim which, under the terms of any such swap, is subordinated to the claims of general unsecured creditors of such covered party);

(C) All claims of the covered party against a counterparty that is not a covered party, or any affiliate of such counterparty that is not a covered party, under any such swap; and

(D) All property securing or any other credit enhancement for any swap described in paragraph (b)(5)(i)(A) of this section or any claim described in paragraphs (b)(5)(i)(B) or (C) of this section under any such swap; and

(iii) The counterparty that is not the covered party consents to any transfer described in paragraph (b)(5)(ii) of this section.

* * * * *

Issued in Washington, DC, on January 20, 2011 by the Commission.

David A. Stawick,

Secretary of the Commission.

Appendices To Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants—Commissioners Voting Summary and Statements of Commissioners

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendix 1—Commissioners Voting Summary

On this matter, Chairman Gensler and Commissioners Dunn, Sommers and Chilton voted in the affirmative; Commissioner O'Malia voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the proposed rulemaking that establishes documentation requirements for swap dealers and major swap participants, ensuring consistency with statutory provisions in the event of an orderly liquidation of a swap dealer or major swap participant. The proposed regulation requires the inclusion of a provision in the swap trading relationship documentation that would inform counterparties that, if a swap dealer or major swap participant becomes a covered financial company subject to the resolution authority of the Federal Deposit Insurance Corporation, there may be a one-day stay on the ability of its counterparties to terminate, liquidate or net their uncleared swaps. The proposed rulemaking should lower litigation risk during times of significant market stress and promote an orderly and effective resolution process for large financial entities.

[FR Doc. 2011–2642 Filed 2–7–11; 8:45 am]

BILLING CODE 6351–01–P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 23

RIN 3038–AC96

Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is proposing regulations to implement new statutory provisions established under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Section 731 of the Dodd-Frank Act added a new section 4s(i) to the Commodity Exchange Act (CEA), which requires the Commission to prescribe standards for swap dealers and major swap participants related to the timely and accurate confirmation, processing, netting, documentation, and valuation of swaps. The proposed rules would establish requirements for swap trading relationship documentation for swap dealers and major swap participants.

DATES: Submit comments on or before April 11, 2011.

ADDRESSES: You may submit comments, identified by RIN number 3038–AC96 and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, by any of the following methods:

- Agency Web site, via its Comments Online process at *http://comments.cftc.gov*. Follow the instructions for submitting comments through the Web site.
- *Mail:* David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.
- *Hand Delivery/Courier:* Same as mail above.
- *Federal eRulemaking Portal: http://www.regulations.gov*. Follow the instructions for submitting comments.

Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov*. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that may be exempt from disclosure

under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the established procedures in § 145.9 of the Commission's regulations, 17 CFR 145.9.

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *http://www.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

FOR FURTHER INFORMATION CONTACT: Sarah E. Josephson, Associate Director, 202–418–5684, *sjosephson@cftc.gov*; Frank N. Fisanich, Special Counsel, 202–418–5949, *ffisanich@cftc.gov*; or Jocelyn Partridge, Special Counsel, 202–418–5926, *jpartridge@cftc.gov*; Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Background

On July 21, 2010, President Obama signed the Dodd-Frank Act.[1] Title VII of the Dodd-Frank Act [2] amended the Commodity Exchange Act (CEA) [3] to establish a comprehensive regulatory framework to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) Providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the Commission's rulemaking and enforcement authorities with respect to all registered entities and intermediaries subject to the Commission's oversight.

Section 731 of the Dodd-Frank Act amends the CEA by adding a new section 4s, which sets forth a number of requirements for swap dealers and major swap participants. Specifically, section 4s(i) of the CEA establishes swap documentation standards for those registrants.

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 timely and accurate confirmation, processing, netting, documentation, and valuation of all swaps." Under section 4s(i)(2), the Commission is required to adopt rules "governing documentation standards for swap dealers and major swap participants." The Commission is proposing the regulations governing swap documentation discussed below, pursuant to the authority granted under sections 4s(h)(1)(D), 4s(h)(3)(D), 4s(i), and 8a(5) of the CEA.[4] The Dodd-Frank Act requires the Commission to promulgate these provisions by July 15, 2011.[5]

The proposed regulations reflect consultation with staff of the following agencies: (i) The Securities and Exchange Commission; (ii) the Board of Governors of the Federal Reserve System; (iii) the Office of the Comptroller of the Currency; and (iv) the Federal Deposit Insurance Corporation. Staff from each of these agencies has had the opportunity to provide oral and/or written comments to the proposal, and the proposed regulations incorporate elements of the comments provided.

In designing these rules, the Commission has taken care to minimize the burden on those parties that will not be registered with the Commission as swap dealers or major swap participants. To the extent that market participants believe that additional measures should be taken to reduce the burden or increase the benefits of documenting swap transactions, the Commission welcomes all comments.

II. Proposed Regulations

The proposed regulations would set forth certain requirements for documenting the swap trading relationship between swap dealers, major swap participants, and their counterparties. Documentation of swaps is a critical component of the bilaterally-traded, over-the-counter (OTC) derivatives market and has been the focus of significant domestic and international attention in recent years.

A. Background on Documentation and Standardization

The OTC derivatives markets traditionally have been characterized by privately negotiated transactions entered into by two counterparties, in which each party assumes and manages the credit risk of the other. While OTC derivatives are traded by a diverse set of market participants, such as banks, hedge funds, pension funds, and other institutional investors, as well as corporate, governmental, and other end-users, a relatively few number of dealers are, by far, the most significantly active participants. As such, the default of a dealer may result in significant losses for the counterparties of that dealer, either from the counterparty exposure to the defaulting dealer or from the cost of replacing the defaulted trades in times of market stress.[6]

OTC derivatives market participants typically have relied on the use of industry standard legal documentation, including master netting agreements, definitions, schedules, and confirmations, to document their swap trading relationships. This industry standard documentation, such as the widely used ISDA Master Agreement and related definitions, schedules, and confirmations specific to particular asset classes, offers a framework for documenting the transactions between counterparties for OTC derivatives products.[7] The standard documentation is designed to set forth the legal, trading, and credit relationship between the parties and to facilitate cross-product netting of transactions in the event that parties have to close-out their position with one another.

One important method of addressing the credit risk that arises from OTC derivatives transactions is the use of bilateral close-out netting. Parties seek to achieve enforceable bilateral netting by documenting all of their transactions under master netting agreements.[8] Following the occurrence of a default by one of the counterparties (such as bankruptcy or insolvency), the

---

[1] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at *http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm*.

[2] Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010."

[3] 7 U.S.C. 1 *et seq.*

[4] Section 8a(5) of the CEA authorizes the Commission to promulgate such regulations as, in the judgment of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the CEA.

[5] This is the sixth rulemaking to be proposed regarding internal business conduct standards for swap dealers and major swap participants. Prior notices of proposed rulemaking are available on the Commission's Web site at *http://www.cftc.gov*.

[6] *See* Financial Stability Board, "Implementing OTC Derivatives Market Reforms: Report of the OTC Derivatives Working Group," (Oct. 10, 2010), available at *http://www.financialstabilityboard.org/publications/r_101025.pdf*.

[7] The International Swaps and Derivatives Association (ISDA) is a trade association for the OTC derivatives industry (*http://www.isda.org*).

[8] Enforceable bilateral netting arrangements are a common commercial practice and are an important part of risk management and minimization of capital costs.

exposures from individual transactions between the two parties are netted and consolidated into a single net "lump sum" obligation. A party's overall exposure is therefore limited to this net sum. That exposure then may be offset by the available collateral previously provided being applied against the net exposure. As such, it is critical that the netting provisions between the parties are legally enforceable and that the collateral may be used to meet the net exposure. In recognition of the risk-reducing benefits of close-out netting, many jurisdictions provide favorable treatment of netting arrangements in bankruptcy,[9] and favorable capital and accounting treatment to parties that have enforceable netting agreements in place.[10]

There is also a risk that inadequate documentation of open swap transactions could result in collateral and legal disputes, thereby exposing counterparties to significant counterparty credit risk. By way of contrast, adequate documentation between counterparties offers a framework for establishing the trading relationship between the parties. The use of common legal documentation also encourages standardization of traded products. This, in turn, may facilitate central clearing and trading as sufficient standardization is a prerequisite for central clearing and trading on an exchange or electronic platform.

In response to the global economic crisis, in September 2009, G–20 Leaders agreed in Pittsburgh to critical elements relating to OTC derivatives reform, including a provision that "[a]ll standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties. * * *"[11] In June 2010 in Toronto, the G–20 Leaders reaffirmed this commitment, and expressly stated their objective of increasing standardization in the OTC derivatives markets.[12] With the passage of the Dodd-Frank Act in July 2010, Congress expressly recognized the link between standardized swaps and clearing, as well.[13]

In addition, increasing standardization of swap documentation should improve the market in a number of other ways, including: Facilitating automated processing of transactions; increasing the fungibility of the contracts, which enables greater market liquidity; improving valuation and risk management; increasing the reliability of price information; reducing the number of problems in matching trades; and facilitating reporting to swap data repositories.[14]

Product and process standardization are also key conditions for increased automation and central clearing of OTC derivatives. As a result of targeted supervisory encouragement since 2005,[15] credit derivative market participants have standardized CDS product design and post-trade processes in tandem, leading to greater operational efficiencies, encouraging higher volumes of standardized transactions, and most significantly, providing the requisite operational environment for the implementation of centralized risk-reducing infrastructure, including central counterparty clearing.

Many standardized processes have been established for CDS legal documentation and trading conventions, and in turn, the standardization of product design has enabled market participants to implement infrastructure that automates and centralizes trading, recordkeeping, trade compression, and clearing. For example, the standardization of coupons in the single-name CDS product was largely motivated by the desire to create an efficient process for offsetting contracts. The market-wide adoption of fixed coupons allowed single-name CDS instruments to be centrally cleared, in effect standardizing counterparty credit risk management in these products. The "Big Bang Protocol" further standardized a number of critical operational processes.[16] The protocol: (i) "Hardwired" a standard auction mechanism into CDS trading documentation, eliminating the need for ad hoc protocols; (ii) incorporated the resolutions of the ISDA Determinations Committees into the terms of standard CDS documentation; and (iii) instituted a common standard effective date for CDS transactions. Codifying key standardized processes into CDS products has brought greater certainty to managing the risk of CDS transactions and has provided the structural foundation for greater automation, higher volumes in standardized transactions, and ultimately the establishment of centralized risk-reducing infrastructure, such as central counterparties.

B. Proposed Swap Trading Relationship Documentation Rule

To promote the "timely and accurate * * * documentation * * * of all swaps" under § 4s(i)(1) of the CEA, proposed § 23.504(a) would require that swap dealers and major swap participants establish, maintain, and enforce written policies and procedures reasonably designed to ensure that each swap dealer or major swap participant and its counterparties have agreed in writing to all of the terms governing their swap trading relationship and have executed all agreements required by proposed § 23.504.

Proposed § 23.504(b)(1) would specify that the swap trading relationship documentation include written agreement by the parties on terms relating to payment obligations, netting of payments, events of default or other termination events, netting of obligations upon termination, transfer of rights and obligations, governing law, valuation, and dispute resolution procedures. Proposed § 23.504(b)(2) would establish that all confirmations of swap transactions, as required under previously proposed § 23.501, would be considered to be part of the required swap trading relationship documentation.

---

[9] *See e.g.,* 11 U.S.C. 561 (protecting contractual right to terminate, liquidate, accelerate, or offset under a master netting agreement and across contracts).

[10] *See* 12 CFR 3, Appendix C; 12 CFR 208, Appendix F; 12 CFR 225, Appendix G; and 12 CFR 325, Appendix D (banking regulations regarding qualifying master netting agreements).

[11] *See* Group of Twenty, "Leaders' Statement: The Pittsburgh Summit," (Sept. 24–25, 2009), available at *http://www.pittsburghsummit.gov/mediacenter/129639.htm.*

[12] *See* The G–20 Toronto Summit Declaration (Jun. 26–27, 2010), available at *http://www.g20.utoronto.ca/2010/g20_declaration_en.pdf.* In Annex II, the declaration stated, "We pledged to work in a coordinated manner to accelerate the implementation of over-the-counter (OTC) derivatives regulation and supervision and to increase transparency and standardization."

[13] "It is expected that the standardized, plain vanilla, high volume swaps contracts—which according to the Treasury Department are about 90 percent of the $600 trillion swaps market—will be subject to mandatory clearing." 156 Cong. Rec. S5921 (daily ed. Jul. 15, 2010) (statement of Sen. Lincoln).

[14] These benefits were articulated by the Financial Stability Board's OTC Derivatives Working Group in its report, "Implementing OTC Derivatives Market Reforms," (Oct. 10, 2010), available at *http://www.financialstabilityboard.org/publications/r_101025.pdf.*

[15] Since 2005, the Federal Reserve Bank of New York (FRBNY) has led a targeted, supervisory effort to enhance operational efficiency and performance in the OTC derivatives market, among other things, by increasing standardization. Known as the OTC Derivatives Supervisors' Group (ODSG), the FRBNY leads an on-going effort with OTC derivatives dealers' primary supervisors, trade associations, industry utilities, and private vendors, through which market participants (including buy-side participants) regularly set goals and commitments to bring infrastructure, market design, and risk management improvements to all OTC derivatives asset classes.

[16] *See* 2009 ISDA Credit Derivatives Determinations Committees and Auction Settlement CDS Protocol, available at: *http://www.isda.org/bigbangprot/docs/Big-Bang-Protocol.pdf.*

Swap trading relationship documentation under proposed § 23.504(b)(3)(i) and (ii) also would include credit support arrangements containing initial and variation margin requirements at least as high as those set by the Commission (for swap dealers and major swap participants that are not banks) and by prudential regulators (for entities that are banks). These credit support arrangements also would be required to identify the forms of eligible assets that may be used as margin and asset valuation haircuts.

Under proposed § 23.504(b)(3)(iii) and (iv), the credit support arrangements between swap dealers and major swap participants would include documentation of the treatment of any assets used as margin for uncleared swaps. These provisions are intended to work together with the rules previously proposed under section 4s(l) of the CEA,[17] and thus require documentation as to whether the funds and other property are to be segregated with an independent third party, in accordance with § 23.601(e). The provisions also are designed to work together with rules to be proposed under section 4s(e) of the CEA that relate to margin requirements.

Under § 23.601, as previously proposed, swap dealers and major swap participants trading uncleared swaps would be required to notify each counterparty that the counterparty has the right to require segregation of the funds or other property that it supplies as "initial margin," a term defined in previously proposed § 23.600.[18] At the request of the counterparty, the swap dealer or major swap participant would be required to segregate such initial margin with an independent third party. Under section 4s(l) of the CEA, this segregation requirement would not apply to variation margin payments. Proposed § 23.602(a)(2), however, would permit the swap dealer or major swap participant and the counterparty to agree that variation margin also may be held in a segregated account. Under proposed § 23.601(e), swap dealers and major swap participants would notify each counterparty of the opportunity to revisit their segregation decision once per calendar year.

Swap dealers and major swap participants also must comply with proposed § 23.603(a), which would provide that segregated initial margin may only be invested consistent with the standards for investment of customer funds that the Commission applies to exchange-traded futures (*see* § 1.25 of Commission regulations), and with proposed § 23.603(b), which would provide that swap dealers and major swap participants and their counterparties may enter into any commercial arrangement, in writing, regarding the investment of segregated initial margin and the related allocation of the gains and losses resulting from such investments. The Commission anticipates that documentation of the foregoing matters would be included in the trading relationship documentation required pursuant to proposed § 23.504(b)(3)(iii).

Swap dealers and major swap participants could maintain standard templates for documenting their trading relationships as a way of complying with the requirements of § 23.504. The Commission would also consider it a sound practice for swap dealers and major swap participants to require senior management in the business trading and risk management units to approve all templates, and any material modifications to them. The Commission recognizes the work that the industry has undertaken over the past several years to update and standardize the documentation it relies upon for various asset classes, and the Commission encourages market participants to adopt standardized confirmation templates, standardized master confirmation agreements,[19] standardized product definitions, and other standardized documentation developed by the industry. Standardized documentation and definitions promote standardized products, which may lead to greater liquidity and more efficient pricing. In addition, increased product standardization may bring systemic risk-reduction benefits as the risks associated with standardized products are better understood by the entire marketplace.

C. Proposed Swap Valuation Provisions

Swap valuation disputes have long been recognized as a significant problem in the OTC derivatives market.[20] The ability to determine definitively the value of a swap at any given time lies at the center of many of the OTC derivatives market reforms contained in the Dodd-Frank Act and is a cornerstone of risk management. Swap valuation is also crucial for determining capital and margin requirements applicable to swap dealers and major swap participants and therefore plays a primary role in risk mitigation for uncleared swaps.

The Commission recognizes that swap valuation is not always an easy task. In some instances, there is widespread agreement on valuation methodologies and the source of formula inputs for frequently traded swaps. These swaps are the proverbial "low-hanging fruit," and many have been accepted for clearing (*i.e.*, commonly traded interest rate swaps and credit default swaps). However, parties often dispute valuations of thinly traded swaps where there is not widespread agreement on valuation methodologies or the source for formula inputs. Many of these swaps are thinly traded either because of their limited use as risk management tools or because they are simply too customized to have comparable counterparts in the market. As many of these swaps are valued by dealers internally by "marking-to-model," their counterparties may dispute the inputs and methodologies used in the model. As uncleared swaps are bilateral, privately negotiated contracts, on-going swap valuation for purposes of initial and variation margin calculation and swap terminations or novations, has also been largely a process of on-going negotiation between the parties. The inability to agree on the value of a swap became especially acute during the 2007–2009 financial crisis when there was widespread failure of the market inputs needed to value many swaps.[21]

[17] *See* 75 FR 75432, *Notice of Proposed Rulemaking, Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy,* Dec. 3, 2010.

[18] *See* 75 FR 75438 ("Initial margin means money, securities, or property posted by a party to a swap as performance bond to cover potential future exposures arising from changes in the market value of the position.").

[19] Standard Master Confirmation Agreements that have been published include:

2004 Sovereign Master Credit Derivatives Confirmation Agreement.

2003 Master Credit Derivatives Confirmation Agreement (Asia-Pacific).

2003 Master Credit Derivatives Confirmation Agreement (European-North American).

2009 Americas Master Equity Derivatives Confirmation Agreement.

2008 Americas Master Designated/Exchange-Traded Contract Option Confirmation Agreement.

2007 Americas Master Variance Swap Confirmation Agreement.

2004 Americas Interdealer Master Equity Derivatives Confirmation Agreement.

[20] *See* ISDA Collateral Committee, "Commentary to the Outline of the 2009 ISDA Protocol for Resolution of Disputed Collateral Calls," June 2, 2009 (stating "Disputed margin calls have increased significantly since late 2007, and especially during 2008 have been the driver of large (sometimes > $1 billion) uncollateralized exposures between professional firms.").

[21] The failure of the market to set a price for mortgage-backed securities led to wide disparities in the valuation of CDS referencing mortgage-backed securities (especially collateralized debt obligations). Such wide disparities led to large collateral calls from dealers on AIG, hastening its downfall. *See* CBS News, "Calling AIG? Internal Docs Reveal Company Silent About Dozens Of Collateral Calls," Jun. 23, 2009, available at:

The Commission believes that prudent risk management requires that market participants be able to value their own swaps in a predictable and objective manner; the failure to do so may lead to systemic risk. Accordingly, to promote the "timely and accurate * * * valuation of all swaps" under § 4s(i)(1) of the CEA, proposed § 23.504(b)(4) would require that the swap trading documentation include written documentation in which the parties agree on the methods, procedures, rules and inputs for determining the value of each swap at any time from execution to the termination, maturity, or expiration of the swap. The agreed methods, procedures, rules and inputs would be required to constitute a complete and independently verifiable methodology for valuing each swap entered into between the parties. Proposed § 23.504(b)(4)(iii) would require that the methodology include complete alternative methods for determining the value of the swap in the event that one or more inputs to the methodology become unavailable or fail, such as during times of market stress or illiquidity. All agreements on valuation would be considered part of the swap trading relationship documentation.

This proposed rule is an important complement to previously proposed § 23.502 (portfolio reconciliation), which requires swap dealers and major swap participants to resolve a dispute over the valuation of a swap within one business day. By requiring agreement with each counterparty on the methods and inputs for valuation of each swap, it is expected that § 23.504(b)(4) will assist swap dealers and major swap participants to resolve valuation disputes in a timely manner, thereby reducing risk.

D. Submission of Swaps for Clearing

Under proposed § 23.504(b)(6), upon acceptance of a swap by a registered derivatives clearing organization (DCO), each swap dealer and major swap participant would be required to create a record containing certain items of information,[22] along with a statement that in accordance with the rules of the DCO, the original swap is extinguished and is replaced by equal and opposite swaps between clearing members and the DCO. This provision would require that all terms of the cleared swap conform to the templates established under the DCO's rules, and that all terms of the swap, as carried on the books of the clearing member, conform to the terms of the cleared swap established under the DCO's rules.

Proposed § 23.504(b)(6), while addressing the issues prescribed under § 4s(i)(1) of the CEA, is intended to correspond to proposed § 39.12(b)(4).[23] The purpose of these provisions is to encourage the standardization of swaps and to avoid differences that could compromise the benefits of clearing between the terms of a swap as carried at the DCO level and at the clearing member level. Any such differences would raise both customer protection and systemic risk concerns. From a customer protection standpoint, if the terms of the swap at the customer level differ from those at the clearing level, then the customer will not receive the full transparency and liquidity benefits of clearing, and legal and basis risk will be introduced into the customer position. Similarly, from a systemic perspective, any differences could diminish overall price discovery and liquidity and increase uncertainties and unnecessary costs into the insolvency resolution process. Standardizing the terms of a swap upon clearing would facilitate trading and promote the mitigation of risk for all participants in the swap markets.

Standardization also will impose structure on the general economic function of the contract and will facilitate automated processing and the ability for participants to replicate the trade easily. This allows market participants to trade in and out of contracts easily and lowers transaction costs, which in turn enables greater market liquidity and expansion of the market to more participants.

E. Documentation Audit and Recordkeeping

In keeping with prudent risk management, § 23.504(c) would require an annual audit of the swap trading relationship documentation required by § 23.504 to ensure compliance with approved documentation policies and procedures and Commission regulations. Proposed § 23.504(d) would require swap dealers and major swap participants to keep records in compliance with this section.

F. Reporting Swap Valuation Disputes

Proposed § 23.504(e) would require that swap dealers and major swap participants promptly notify the Commission, any applicable prudential regulator, and the Securities and Exchange Commission with regard to security-based swap agreements if any swap valuation dispute is not resolved within one business day, if the dispute is with a counterparty that is a swap dealer or major swap participant; or within five business days, if the dispute is with a counterparty that is not a swap dealer or major swap participant. This proposed rule would complement previously proposed § 23.502, which requires portfolio reconciliation and resolution of valuation disputes. It also would allow authorities to recognize and respond to outstanding swap valuation disputes, which if left uncollateralized, may lead to systemic risk.

G. Proposed End User Exception Documentation Rule

Proposed § 23.505 would work together with the swap data recordkeeping and reporting requirements rules and end-user exception to mandatory clearing rules, both previously proposed by the Commission.[24] Under these previously proposed rules, "a swap otherwise subject to mandatory clearing is subject to an elective exception from clearing if one party to the swap is not a financial entity, is using the swaps to hedge or mitigate commercial risk, and notifies the Commission * * * how it generally meets its financial obligations associated with entering into non-cleared swaps (the 'end-user clearing exception')."[25] Under previously proposed § 39.6, the end-user clearing exception is elected by providing ten additional items of information to a swap data repository (SDR) through a "check-the-box notification process."[26] As explained in the swap data recordkeeping and reporting rules, swap dealers and major swap participants will have the responsibility for reporting to SDRs "with respect to the majority of swaps."[27] In order to ensure that swap dealers and major swap participants comply with all mandatory clearing requirements and in light of their unique reporting obligations, it is critical that they possess documentation

http://www.cbsnews.com/stories/2009/06/23/cbsnews_investigates/main5106672.shtml.

[22] Such information includes the date and time the swap was accepted for clearing, the name of the DCO clearing the swap, the name of the clearing member clearing the swap for the swap dealer or major swap participant, and, if known, the name of the clearing member clearing the swap for the counterparty.

[23] The proposed *Notice of Proposed Rulemaking, Risk Management Requirements for Derivatives Clearing Organizations* under part 39 are available on the Commission's Web site at *http://www.cftc.gov.*

[24] *See Swap Data Recordkeeping and Reporting Requirements*, 75 FR 76573, Dec. 8, 2010, and *End-User Exception to Mandatory Clearing of Swaps*, 75 FR 80747, Dec. 23, 2010.

[25] 75 FR at 80748.

[26] 75 FR at 80749 and 80755.

[27] 75 FR at 76593; *see also* section 4r of the CEA.

sufficient to support a reasonable belief that their counterparties meet the statutory requirements for electing an exception from mandatory clearing. Accordingly, the Commission is proposing § 23.505.

Proposed § 23.505 would require swap dealers and major swap participants to obtain documentation from any counterparty seeking to exercise its rights under the end-user clearing exception from the mandatory clearing requirement under section 2h(7) of the CEA. For swaps subject to the mandatory clearing requirement, the proposed rule would require that swap dealers and major swap participants comply with any mandatory clearing requirement by obtaining documentation sufficient to provide the swap dealer or major swap participant with a reasonable basis to believe that its counterparty meets the statutory conditions required for an exception from a mandatory clearing requirement, as defined in section 2h(7) of the CEA.

H. Application of Proposed Regulations to Existing Swap Documentation

The Commission recognizes that amending all existing trading relationship documentation would present a substantial undertaking for the market. Therefore, the Commission invites comment on the implementation of proposed § 23.504. While much of the existing swap documentation among swap dealers, major swap participants, and their counterparties likely would be in compliance with § 23.504(b), the Commission requests comment on an appropriate interval following the effective date of the regulations after which to require compliance. This interval is expected to be somewhat shorter for swap documentation among swap dealers and major swap participants, and somewhat longer for swap documentation between swap dealers, major swap participants, and counterparties that are not swap dealers or major swap participants.

The Commission also recognizes that many swap dealers and major swap participants may have dormant trading relationships with counterparties where swap documentation has been executed, but no trades are presently in effect thereunder or there are trades that will run-off over a short period of time, and there is no intention to enter into new trades. Therefore, the Commission invites comment on whether to provide a safe harbor for dormant trading relationships.

I. Comment Requested

The Commission requests comment on all aspects of proposed §§ 23.504 and 23.505. The Commission recognizes that there will be differences in the size and scope of the business of particular swap dealers and major swap participants. Therefore, comments are solicited on whether certain provisions of the proposed regulations should be modified or adjusted to reflect the differences among swap dealers and major swap participants or differences among asset classes. In particular, the Commission requests comment on the following questions:

- How long would swap dealers and major swap participants require to bring their existing documentation into compliance with § 23.504? Will compliance take less time for existing documentation between such registrants and longer for existing documentation between registrants and non-registrants? Would three months following the effective date of the rules be long enough for registrants to bring existing documentation among themselves into compliance? Would six months following the effective date of the rules be long enough for registrants to bring existing documentation with non-registrants into compliance?
- Should § 23.504 include a safe harbor for swaps entered into on, or subject to the rules of, a board of trade designated as a contract market?
- Should § 23.504 require that the governing body of each swap dealer or major swap participant approve the policies and procedures for agreeing with each counterparty to all the terms governing the trading relationship?
- Should any other aspects of the trading relationship be required to be included in § 23.504?
- Should the requirement for agreement on events of default or termination events be further defined? For example, should parties be required to specify all cross default implications and potential claims with regard to their respective affiliates and any other present or future debt obligations or transactions?
- Should § 23.504 specifically delineate the types of payment obligation terms that must be included in the trading relationship documentation?
- Should specific requirements for dispute resolution be included in § 23.504 (such as time limits), and if so, what requirements are appropriate for all swaps?
- Should the valuation agreement in § 23.504(b)(4) require greater specificity? If so, what level of detail should be required?
- Should the valuation methodology provision in § 23.504(b)(4) expressly prohibit use of internal and/or proprietary inputs and methods and if not, why are inputs and methods developed and verifiable only by one party to the swap transaction acceptable given the safety and soundness and transparency objectives of the Dodd-Frank Act?
- If internal and/or proprietary inputs or procedures are permitted under § 23.504(b)(4), should the swap dealer or major swap participant be required to disclose such information and the sources thereof to the counterparty and regulators in sufficient detail for them to undertake comparative analysis of such information and verify the valuation calculations?
- Under proposed § 23.504(b)(6)(v), should all the terms of the cleared swap be required to conform to the templates established by the DCO or are there particular terms or rights under the swap that could be retained without prejudice to the need to standardize swaps for the purposes of clearing?
- Is the requirement that each swap dealer and major swap participant conduct an independent internal or external audit of no less than 5% of the swap trading relationship documentation required by the rule executed during the previous twelve month period appropriate?
- Would a failure of swap trading relationship documentation to comply with the requirements of proposed § 23.504 create uncertainty regarding the enforceability of swaps transacted under such non-compliant documentation? If so, how should this uncertainty be addressed in the rules?
- Are the requirements of proposed § 23.505 appropriate? How should swap dealers and major swap participants verify that their counterparties are properly claiming an exception from a given mandatory clearing requirement?
- Are there any anticompetitive implications to the proposed rules? If so, how could the proposed rules be implemented to achieve the purposes of the CEA in a less anticompetitive manner?

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities.[28] The Commission previously has established certain definitions of "small entities" to be used in evaluating the impact of its regulations on small entities in accordance with the RFA.[29]

[28] 5 U.S.C. 601 *et seq.*

[29] 47 FR 18618, Apr. 30, 1982.

The proposed rules would affect swap dealers and major swap participants.

Swap dealers and major swap participants are new categories of registrants. Accordingly, the Commission has not previously addressed the question of whether such persons are, in fact, small entities for purposes of the RFA. The Commission previously has determined, however, that futures commission merchants should not be considered to be small entities for purposes of the RFA.[30] The Commission's determination was based, in part, upon the obligation of futures commission merchants to meet the minimum financial requirements established by the Commission to enhance the protection of customers' segregated funds and protect the financial condition of futures commission merchants generally.[31] Like futures commission merchants, swap dealers will be subject to minimum capital and margin requirements and are expected to comprise the largest global financial firms. The Commission is required to exempt from swap dealer designation any entities that engage in a de minimis level of swaps dealing in connection with transactions with or on behalf of customers. The Commission anticipates that this exemption would tend to exclude small entities from registration. Accordingly, for purposes of the RFA for this rulemaking, the Commission is hereby proposing that swap dealers not be considered "small entities" for essentially the same reasons that futures commission merchants have previously been determined not to be small entities and in light of the exemption from the definition of swap dealer for those engaging in a de minimis level of swap dealing.

The Commission also has previously determined that large traders are not "small entities" for RFA purposes.[32] In that determination, the Commission considered that a large trading position was indicative of the size of the business. Major swap participants, by statutory definition, maintain substantial positions in swaps or maintain outstanding swap positions that create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets. Accordingly, for purposes of the RFA for this rulemaking, the Commission is hereby proposing that major swap participants not be considered "small entities" for essentially the same reasons that large traders have previously been determined not to be small entities.

Moreover, the Commission is carrying out Congressional mandates by proposing this regulation. Specifically, the Commission is proposing these regulations to comply with the Dodd-Frank Act, the aim of which is to reduce systemic risk presented by swap dealers and swap market participants through comprehensive regulation. The Commission does not believe that there are regulatory alternatives to those being proposed that would be consistent with the statutory mandate. Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that the proposed rules will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act (PRA)[33] imposes certain requirements on Federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. This proposed rulemaking would result in new collection of information requirements within the meaning of the PRA. The Commission therefore is submitting this proposal to the Office of Management and Budget (OMB) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for this collection of information is "Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The OMB has not yet assigned this collection a control number.

The collection of information under these proposed rules is necessary to implement new section 4s(i) the CEA, which expressly requires the Commission to adopt rules governing documentation standards for swap dealers and major swap participants and explicitly obligates such registrants to conform to the documentation standards established by the Commission. The required recordkeeping is particularly essential to ensuring that each swap dealer and major swap participant documents all of the terms of its swap trading relationships with its counterparties. Obligating certain swap market participants to memorialize, in writing, their mutual agreement with respect to margin requirements, margin assets, payment and netting, termination events, the calculation and netting of obligations upon termination, transfer of rights and obligations, governing law, valuation methods and inputs, and dispute resolution procedures would decrease the likelihood of significant counterparty disputes; promote transaction standardization; enhance the parties' abilities to engage in risk-reducing exercises such as bilateral offset, portfolio reconciliation, and portfolio compression; provide for more timely and orderly resolution of events of default; and enhance the stability of the market place as a whole. The proposed regulations also would ensure that certain important information regarding cleared swaps would be preserved and would assist in ensuring compliance with the mandatory clearing requirements of the Act and Commission regulations by requiring the maintenance of documentation demonstrating that the statutory conditions for an exception to those requirements have been satisfied. The reporting requirement established by the proposed rules would ensure that the Commission is provided with timely notification of swap valuation disputes that relevant market participants have been unable to resolve promptly.

The proposed regulation would be an important part of the Commission's regulatory program for swap dealers and major swap participants. The information required to be preserved would be used by representatives of the Commission and any examining authority responsible for reviewing the activities of the swap dealer or major swap participant to ensure compliance with the CEA and applicable Commission regulations.

If the proposed regulations are adopted, responses to this collection of information would be mandatory. The Commission will protect proprietary information according to the Freedom of Information Act and 17 CFR part 145, "Commission Records and Information." In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public "data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers." The Commission also is required to protect certain information contained in a government system of records according to the Privacy Act of 1974, 5 U.S.C. 552a.

1. Information Provided By Reporting Entities/Persons

Proposed § 23.504 generally would require swap dealers and major swap participants to develop and retain

[30] *Id.* at 18619.

[31] *Id.*

[32] *Id.* at 18620.

[33] 44 U.S.C. 3501 *et seq.*

written swap trading relationship documentation (including the parties' agreement with respect to the terms specified in the regulation; credit support arrangements; valuation methods, procedures and inputs; records of important information regarding their cleared swaps; and written policies and procedures for maintaining the documentation required by the proposed rule). It also would require swap dealers and major swap participants to report to the Commission and, as applicable, to the Securities and Exchange Commission or prudential regulators, swap valuation disputes that have not been resolved between the parties within designated time frames. Proposed § 23.505 would require swap dealers and major swap participants to obtain documentation sufficient to provide a reasonable basis on which to believe that a counterparty meets the statutory conditions necessary for an exception from the mandatory clearing requirements, where applicable.

The information collection burden associated with the proposed regulations is estimated to be 6,168 hours per year, at an initial annual cost of $684,300 for each swap dealer and major swap participant. The aggregate information collection burden is estimated to be 1,850,400 hours per year, at an initial annual aggregate cost of $205,290,000. Burden means the total time, effort or financial resources expended by persons to generate, maintain, retain, disclose, or provide information to or for a Federal agency. The Commission has characterized the annual costs as initial costs as the Commission anticipates that the cost burdens will be reduced dramatically over time as the agreements and other records required by the proposed regulations become increasingly standardized within the industry.

The Commission anticipates that the majority of the information collection burden would arise from the recordkeeping obligations contained in § 23.504(b). Proposed § 23.504(b) would require each swap dealer and major swap participant to create and maintain written trading relationship documentation that contains the parties' agreement with respect to all of the terms of the parties' trading relationship including, without limitation, the terms delineated in § 23.504(b)(1); the parties' credit support arrangements, including the margin-related terms described in § 23.504(b)(3); and the parties' agreement with respect to the particular procedures and inputs that will be used to determine the value of a swap from execution to termination, maturity, or expiration in a manner that can be independently replicated as required by § 23.504(b)(4). It also requires swap dealers and major swap participants to make and maintain records of cleared swaps containing the data contained in proposed § 23.504(b)(6).

Maintenance of written credit support arrangements and other trading relationship documentation that contain the terms required to be memorialized by the proposed §§ 23.504(b)(1) and (3) is prudent business practice and the Commission anticipates that swap dealers and major swap participants already maintain some form of this documentation with each of their counterparties in the ordinary course of their business. Moreover, proposed § 23.504(b)(2) provides that the swap transaction confirmations described under previously proposed § 23.501 would be considered part of the parties' trading relationship documentation and thus, pre-existing swap confirmations that include the terms required by § 23.504 would obviate the need for the parties to develop new documentation with respect to those terms.[34] Accordingly, any additional expenditure related to §§ 23.504(b)(1) and (3) likely would be limited to the time initially required to review and, as needed, to re-negotiate and amend, existing trading relationship documentation to ensure that it encompasses all of the required terms and to develop a system for maintaining any newly created records. Many of the amended provisions are likely to apply to multiple counterparties, thereby reducing the per counterparty hour burden.

With respect to the valuation agreement requirement established by proposed § 23.504(b)(4), the Commission believes that swap dealers and major swap participants are likely to have existing, internal mechanisms for valuing their swaps transactions and thus, the hour burden associated with this obligation would be limited to the time needed to negotiate agreements with counterparties on mutually acceptable valuation methods, should their individual valuation procedures differ, and to commit the agreement to writing as part of the parties' swap trading relationship documentation. It is likely that the need for new valuation agreements may be limited further to instances of complex or highly customized swaps transactions, as the valuation methods for "plain vanilla" swaps are likely to be somewhat standardized.

The Commission estimates the initial annual hour burden associated with negotiating, drafting, and maintaining the swap trading relationship documentation described above that is required by proposed § 23.504(b) (excluding the cleared swap records required by proposed § 23.504(b)(6)), to be 10 hours per counterparty, or an average of 5,400 hours per swap dealer or major swap participant. As stated above, the Commission expects that this annual per registrant burden would be reduced considerably over time as there would be little need to modify the swap trading relationship documentation on an ongoing basis. Once a swap dealer or major swap participant modifies its pre-existing documentation with each of its counterparties, the annual burden associated with the swap trading relationship documentation would be minimal. In addition, because all swap dealers and major swap participants would be required to maintain the swap trading relationship documentation established by the proposed regulation, the Commission believes that it is likely that many of the terms of such documentation would become progressively more standardized within the industry, further reducing the bilateral negotiation and drafting responsibilities associated with the regulation.

With respect to the required records of cleared swaps, the Commission estimates that swap dealers and major swap participants will spend an average of 2 hours per trading day, or 504 hours per year, maintaining the required data for these transactions. The Commission notes that the specific information required for each transaction is limited and is of the type that would be maintained in a prudent market participant's ordinary course of business. The Commission also notes that the statement required to be preserved for each cleared swap likely would become common to each derivatives clearing organization.

In addition to the above, the Commission anticipates that swap dealers and major swap participants will spend an average of 16 hours per year drafting and, as needed, updating the written policies and procedures required by proposed § 23.504(a); 4 hours per year maintaining records of the results of the annual documentation compliance audits mandated by proposed § 23.504(c); and 220 hours per year, or 1 hour per end user, maintaining records of the

[34] The information collection burden associated with the maintenance of confirmations of swaps transactions was calculated and accounted for in previously proposed regulations. *See* Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 FR 81519, Dec. 28, 2010.

documentation required by proposed § 23.505.

The only reporting requirement contained in the proposed rules is the obligation of swap dealers and major swap participants to report swap valuation disputes that are not resolved between the participants within designated time periods. The Commission expects that swap dealers and major swap participants will spend an average of 24 hours per year satisfying this requirement.

The hour burden calculations below are based upon a number of variables such as the number of swap dealers and major swap participants in the marketplace, the average number of counterparties of each of these registrants, and the average hourly wage of the employees of these registrants that would be responsible for satisfying the obligations established by the proposed regulation. Swap dealers and major swap participants are new categories of registrants. Accordingly, it is not currently known how many swap dealers and major swap participants will become subject to these rules, and this will not be known to the Commission until the registration requirements for these entities become effective after July 16, 2011, the date on which the Dodd-Frank Act becomes effective. While the Commission believes there will be approximately 200 swap dealers and 50 major swap participants, it has taken a conservative approach, for PRA purposes, in estimating that there will be a combined number of 300 swap dealers and major swap participants who will be required to comply with the recordkeeping requirements of the proposed rules. The Commission estimated the number of affected entities based on industry data.

Similarly, due to the absence of prior experience in regulating swap dealers and major swap participants and with regulations similar to the proposed rules, the actual, average number of counterparties that a swap dealer or major swap participant is likely to have and the average size of its portfolio with particular counterparties is uncertain. Consistent with other proposed rulemakings, the Commission has estimated that each of the 14 major swap dealers has an average 7,500 counterparties and the other 286 swap dealers and major swap participants have an average of 200 counterparties per year, for an average of 540 total counterparties per registrant.

The Commission anticipates that the written policies and procedures required by the proposed regulations, along with the recordkeeping and reporting requirements, typically would be drafted and maintained by in-house counsel and financial or operational managers within the firm.[35] According to the Bureau of Labor Statistics findings, the mean hourly wage of an employee under occupation code 23–1011, "Lawyers," that is employed by the "Securities and Commodity Contracts Intermediation and Brokerage Industry" is $82.22.[36] The mean hourly wage of an employee under occupation code 11–3031, "Financial Managers," (which includes operations managers) in the same industry is $74.41.[37] Because swap dealers and major swap participants include large financial institutions whose employees' salaries may exceed the mean wage provided, however, the Commission generally has estimated the cost burden of the proposed regulations based upon an average salary of $100 per hour. To account for the possibility that the services of outside counsel may be required to satisfy the requirements associated with negotiating, drafting, and maintaining the required trading relationship documentation (except the cleared swap records), the Commission has used an average salary of $125 per hour to calculate this burden for one half of the necessary hours.

Based upon the above, the estimated hour burden was calculated as follows:

Drafting and Updating Policies and Procedures. This hour burden arises from the time necessary to develop and periodically update the policies and procedures required by the proposed regulations.

Number of registrants: 300.

Frequency of collection: Initial drafting, updating as needed.

Estimated number of annual responses per registrant: 1.

Estimated aggregate number of annual responses: 300.

Estimated annual hour burden per registrant: 16 hours.

Estimated aggregate annual hour burden: 4,800 burden hours [300 registrants × 16 hours per registrant].

Swap Trading Relationship Documentation (excluding cleared swaps records). This hour burden arises from the proposed obligation that swap dealers and major swap participants execute and maintain swap trading relationship documentation.

Number of registrants: 300.

Frequency of collection: At least once per counterparty.

Estimated number of annual responses per registrant: 540 [one set of agreements per counterparty].

Estimated aggregate number of annual responses: 162,000 [300 registrants × 540 counterparties].

Estimated annual hour burden per registrant: 5,400 [540 counterparties × 10 hours per counterparty].

Estimated aggregate annual hour burden: 1,620,000 [300 registrants × 5,400 hours per registrant].

Cleared Swap Recordkeeping. This hourly burden arises from the proposed requirement that swap dealers and major swap participants make and maintain records of specified information related to each swap accepted for clearing by a derivatives clearing organization.

Number of registrants: 300.

Frequency of collection: Daily.

Estimated number of annual responses per registrant: 252 [252 trading days per year].[38]

Estimated aggregate number of annual responses: 75,600 [300 registrants × 252 trading days].

Estimated annual hour burden per registrant: 504 [252 trading days × 2 hours per trading day].

Estimated aggregate hour burden: 151,200 [300 registrants × 504 hours].

Audit Recordkeeping. This hourly burden arises from the proposed requirement that swap dealers and major swap participants make and maintain records of the results of their annual internal or external audits to examine for compliance with the requirements of the proposed regulations.

Number of registrants: 300.

Frequency of collection: Annually.

Estimated number of annual responses per registrant: 1.

Estimated aggregate number of annual responses: 300 [300 registrants × 1].

Estimated annual hour burden per registrant: 4.

[35] The written policies and procedures also may be drafted and maintained by the chief compliance officer of the swap dealer or major swap participant. According to recent Bureau of Labor Statistics findings, the mean hourly wage of any employee under occupation code 13–1401, "Compliance Officers, Except Agriculture, Construction, Health and Safety, and Transportation," that is employed by the "Securities and Commodity Contracts Intermediation and Brokerage Industry is $38.77. *http://www.bls.gov/oes/current/oes131041.htm.*

[36] *http://www.bls.gov/oes/2099/mayowe23.1011.htm.*

[37] *http://www.bls.gov/oes/current/oes113031.htm.*

[38] Consistent with the Commission's proposed regulations that would require swap dealers and major swap participants to compile and maintain certain transaction records (including daily trading records), the Commission has estimated the hour burden associated with the cleared swap recordkeeping requirement by approximating the number of hours per trading day that an employee of a swap dealer or major swap participant likely would spend compiling and retaining the relevant records. *See* Reporting, Recordkeeping, and Daily Trading Record Requirements for Swap Dealers and Major Swap Participants, 75 FR 76666, Dec. 9, 2010.

Estimated aggregate annual hour burden: 1,200 [300 registrants × 4 hours].

Valuation Dispute Reporting. This hourly burden arises from the proposed requirement that swap dealers and major swap participants submit reports of certain unresolved valuation disputes.

Number of registrants: 300.

Frequency of collection: As applicable.

Estimated number of annual responses per registrant: 240.

Estimated aggregate number of annual responses: 72,000 [300 registrants × 240 responses].

Estimated annual hour burden per registrant: 24.

Estimated aggregate annual hour burden: 7,200 [300 registrants × 24 hours].

End user Exception Documentation Recordkeeping. This hourly burden arises from the proposed requirement that swap dealers and major swap participants make and maintain records of its end user exception documentation.

Number of registrants: 300.

Frequency of collection: Once per applicable counterparty.

Estimated number of annual responses per registrant: 220.[39]

Estimated aggregate number of annual responses: 66,000 [300 registrants × 220 responses].

Estimated annual hour burden per registrant: 220 [220 responses × 1 hour per response].

Estimated aggregate annual hour burden: 66,000 [300 registrants × 220 responses].

In addition to the per hour burden discussed above, the Commission anticipates that swap dealers and major swap participants may incur certain start-up costs in connection with the proposed recordkeeping obligations. Such costs would include the expenditures related to developing and installing new recordkeeping technology or re-programming or updating existing recordkeeping technology and systems to enable the swap dealer or major swap participant to collect, maintain, and re-produce any newly required records. The Commission believes that swap dealers and major swap participants generally could adapt their current infrastructure to accommodate the new or amended technology and thus, no significant infrastructure expenditures would be needed. The Commission estimates the programming burden hours associated with technology improvements to be 40 hours.

According to recent Bureau of Labor Statistics findings, the mean hourly wages of computer programmers under occupation code 15–1021 and computer software engineers under program codes 15–1031 and 1032 are between $34.10 and $44.94.[40] Because swap dealers and major swap participants generally will be large entities that may engage employees with wages above the mean, the Commission has conservatively chosen to use a mean hourly programming wage of $60 per hour. Accordingly, the start-up burden associated with the required technological improvements would be $2,400 [$60 × 40 hours per affected registrant] or $720,000 in the aggregate.

2. Information Collection Comments

The Commission invites the public and other Federal agencies to comment on any aspect of the recordkeeping burdens discussed above. The Commission specifically requests comment on the variables used in the above-referenced hourly burden calculations. For example, the Commission requests comment on the following:

- What is the total number of swap dealers and major swap participants in the marketplace?
- What is the average number of counterparties that a swap dealer or major swap participant is likely to have?
- What percentage of those counterparties are other swap dealers or major swap participants?
- What percentage of those counterparties is likely to meet the statutory qualifications required for an exception from the mandatory clearing requirement, as defined in section 2h(7) of the CEA and § 39.6?
- What is the average size (number of swaps) of a portfolio that a swap dealer or major swap participant is likely to have with a particular type of counterparty?
- To what extent do swap dealers and major swap participants currently enter into agreements that would satisfy the requirements of proposed § 23.504?
- To what extent would swap dealers and major swap participants be able to standardize the swap trading relationship documentation required by § 23.504?
- To what extent would swap dealers and major swap participants be required to utilize the services of outside counsel in negotiating and drafting the swap trading relationship documentation and valuation and termination rights agreements that would be required by proposed § 23.504?

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Comments may be submitted directly to the Office of Information and Regulatory Affairs, by fax at (202) 395–6566 or by e-mail at *OIRAsubmissions@omb.eop.gov.* Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Refer to the **ADDRESSES** section of this notice of proposed rulemaking for comment submission instructions to the Commission.

A copy of the supporting statements for the collections of information discussed above may be obtained by visiting *RegInfo.gov.* OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment is best assured of having its full effect if OMB receives it within 30 days of publication.

C. Cost-Benefit Analysis

Section 15(a) of the CEA [41] requires the Commission to consider the costs and benefits of its actions before issuing a rulemaking under the CEA. By its terms, section 15(a) does not require the Commission to quantify the costs and benefits of a new regulation or to determine whether the benefits of the rule outweigh its costs; rather, it requires that the Commission "consider" the costs and benefits of its actions.

Section 15(a) further specifies that costs and benefits of a proposed rulemaking shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and

[39] The Commission estimates that half of the counterparties that are not swap dealers or major swap participants may claim the end user exception on an annual basis.

[40] *http://www.bls.gov/oes/current/oes113031.htm.*

[41] 7 U.S.C. 19(a).

financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may, in its discretion, give greater weight to any one of the five enumerated considerations and could, in its discretion, determine that, notwithstanding its costs, a particular regulation was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the CEA.

Summary of proposed requirements. The proposed regulations would implement new section 4s(i) of the CEA, which was added by section 731 of the Dodd-Frank Act. The proposed regulations would establish certain documentation requirements applicable to swap dealers and major swap participants and related recordkeeping and reporting obligations.

Costs. With respect to costs, the Commission has determined that the cost that would be borne by swap dealers and major swap participants to institute the policies and procedures, make and maintain the records, and perform the event-based reporting necessary to satisfy the new regulatory requirements are far outweighed by the benefits that would accrue to the financial system as a whole as a result of the implementation of the rules.

For example, memorializing the specific terms of the swap trading relationship and swap transactions between counterparties is prudent business practice and, in fact, many market participants already use standardized documentation. Accordingly, it is believed that many, if not most, swap dealers and major swap participants currently execute and maintain trading relationship documentation of the type required by proposed § 23.504 in the ordinary course of their businesses, including documentation that contains several of the terms that would be required by the proposed rules. Thus, the hour and dollar burdens associated with the swap trading relationship documentation requirements may be limited to amending existing documentation to expressly include any additional terms required by the proposed rules.

The Commission recognizes that swap dealers and major swap participants may face certain costs, such as the legal fees associated with negotiating and drafting the required documentation modifications, as they and their counterparties come into compliance with the new regulations. However, the Commission also believes that, to the extent that any substantial amendments or additions to existing documentation would be needed, such revisions would likely apply to multiple counterparties, thereby reducing the per counterparty burden imposed upon swap dealers and major swap participants. The Commission further expects the per hour and dollar burdens to be incurred predominantly in the first year or two after the effective date of the final regulations. Once a swap dealer or major swap participant has changed its pre-existing documentation with each of its counterparties to comply with the proposed rules, there likely will be little need to further modify such documentation on an ongoing basis. In addition, the Commission anticipates that standardized swap trading relationship documentation will develop quickly and progressively within the industry, dramatically reducing the cost to individual participants.

The Commission expects the per hour burden associated with the remaining requirements of §§ 23.504 and 23.505 to be relatively minimal. The same is true of the sole reporting requirement contained in § 23.504. Such reporting is event-based and the Commission expects that instances of valuation disputes will decrease over time as valuation agreements are committed to writing pursuant to the proposed regulations.

Finally, the Commission notes that most swap dealers and major swap participants have back office personnel, operational systems, and resources capable of maintaining the required records, performing the periodic reporting, and otherwise adjusting to the new regulatory framework without material diversion of resources away from commercial operations or substantial capital investment.

Benefits. With respect to benefits, the Commission has determined that the proposed regulations that would require a swap dealer or major swap participant to document its swap trading relationship with each of its counterparties will promote standardization of documents and transactions, facilitate central trading and clearing, promote legal and financial certainty, decrease the number and scope of counterparty disputes, promote the timely resolution of disputes when they occur, and enhance the parties' abilities to engage in risk-reducing activities and will result in reduced risk, increased transparency, and greater liquidity and market integrity in the swaps marketplace. Moreover, the cleared swap records that are required to be preserved and the mandatory reporting of unresolved valuation disputes will be valuable tools in the Commission's oversight of the affected registrants. Therefore, the Commission believes it is prudent to prescribe these proposed regulations.

Public Comment. The Commission invites public comment on its cost-benefit considerations. Commentators are also invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the proposed rules with their comment letters.

List of Subjects in 17 CFR Part 23

Antitrust, Commodity futures, Conduct standards, Conflict of Interests, Major swap participants, Reporting and recordkeeping, Swap dealers, Swaps.

For the reasons stated in this release, the Commission proposes to amend 17 CFR part 23, as proposed to be added in FR Doc. 2010–29024, published in the **Federal Register** on November 23, 2010 (75 FR 71379), and as proposed to be amended in FR Doc. 2010–32264, published in the **Federal Register** on December 28, 2010 (75 FR 81519) as follows:

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

1. The authority citation for part 23 is revised to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b–1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

2. Revise the table of contents for part 23, subpart I to read as follows:

Subpart I—Swap Documentation

Sec.

3. Add § 23.504 and § 23.505 to part 23, subpart I, to read as follows:

§ 23.504 Swap trading relationship documentation.

(a) *Policies and procedures.* Each swap dealer and major swap participant shall establish, maintain, and enforce written policies and procedures reasonably designed to ensure that, prior to or contemporaneously with entering into a swap transaction with any counterparty, other than a derivatives clearing organization, the swap dealer or major swap participant executes written swap trading relationship documentation with its counterparty that complies with the requirements of this section. The

policies and procedures shall be approved in writing by senior management of the swap dealer and major swap participant, and a record of the approval shall be retained.

(b) *Swap trading relationship documentation.* (1) The swap trading relationship documentation shall be in writing and shall include all terms governing the trading relationship between the swap dealer or major swap participant 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 procedures.

(2) The swap trading relationship documentation shall include all confirmations of swap transactions under § 23.501.

(3) The swap trading relationship documentation shall include credit support arrangements, which shall contain, in accordance with applicable requirements under Commission regulations or regulations adopted by prudential regulators and without limitation, the following:

(i) Initial and variation margin requirements;

(ii) Types of assets that may be used as margin and asset valuation haircuts;

(iii) Investment and rehypothecation terms for assets used as margin for uncleared swaps; and

(iv) Custodial arrangements for margin assets, including whether margin assets are to be segregated with an independent third party, in accordance with § 23.601(e).

(4) The swap trading relationship documentation shall include written documentation in which the parties agree on the methods, procedures, rules, and inputs for determining the value of each swap at any time from execution to the termination, maturity, or expiration of such swap. To the maximum extent practicable, the valuation of each swap shall be based on objective criteria, such as recently-executed transactions or valuations provided by independent third parties such as derivatives clearing organizations.

(i) Such methods, procedures, rules, and inputs shall be agreed for each swap prior to or contemporaneously with execution and shall be stated with the specificity necessary to allow the swap dealer, major swap participant, counterparty, the Commission, and any applicable prudential regulator to determine the value of the swap independently in a substantially comparable manner.

(ii) Such methods, procedures, and rules shall include alternative methods for determining the value of the swap in the event of the unavailability or other failure of any input required to value the swap, provided that the alternative methods for valuing the swap comply with the requirements of this section.

(iii) Provided that the requirements of this paragraph, including the independent valuation requirement of paragraph (b)(4)(i) of this section, are satisfied, a swap dealer or major swap participant is not required to disclose to the counterparty confidential, proprietary information about any model it may use internally to value a swap for its own purposes.

(5) [Reserved]

(6) Upon acceptance of a swap by a derivatives clearing organization, the swap trading relationship documentation shall include a record of the following information:

(i) The date and time the swap was accepted for clearing;

(ii) The name of the derivatives clearing organization;

(iii) The name of the clearing member clearing for the swap dealer or major swap participant;

(iv) The name of the clearing member clearing for the counterparty, if known; and

(v) A statement that in accordance with the rules of the derivatives clearing organization:

(A) The original swap is extinguished;

(B) The original swap is replaced by equal and opposite swaps between clearing members and the derivatives clearing organization;

(C) All terms of the cleared swap conform to templates established under the derivatives clearing organization's rules; and

(D) All terms of the swap, as carried on the books of the clearing member, conform to the terms of the cleared swap established under the derivatives clearing organization's rules.

(c) *Audit of swap trading relationship documentation.* At least once during each calendar year, each swap dealer and major swap participant shall have an independent internal or external auditor examine no less than 5% of the swap trading relationship documentation required by this section created during the previous twelve month period to ensure compliance with Commission regulations and the written policies and procedures established pursuant to this section. A record of the results of each audit shall be retained.

(d) *Recordkeeping.* Each swap dealer and major swap participant shall maintain all documents required to be created pursuant to this section in accordance with § 1.31 of this chapter and shall make them available promptly upon request to any representative of the Commission or any applicable prudential regulator, or with regard to swaps defined in section 1a(47)(A)(v) of the Act, to any representative of the Commission, the Securities and Exchange Commission, or any applicable prudential regulator.

(e) *Reporting.* Each swap dealer and major swap participant shall promptly notify the Commission and any applicable prudential regulator, or with regard to swaps defined in section 1a(47)(A)(v) of the Act, the Commission, the Securities and Exchange Commission, and any applicable prudential regulator, of any swap valuation dispute not resolved within:

(1) One (1) business day, if the dispute is with a counterparty that is a swap dealer or major swap participant; or

(2) Five (5) business days, if the dispute is with a counterparty that is not a swap dealer or major swap participant.

§ 23.505 End user exception documentation.

(a) *For swaps excepted from a mandatory clearing requirement.* Each swap dealer and major swap participant shall obtain documentation sufficient to provide a reasonable basis on which to believe that its counterparty meets the statutory conditions required for an exception from a mandatory clearing requirement, as defined in section 2h(7) of the Act and § 39.6 of this chapter. Such documentation shall include:

(1) The identity of the counterparty;

(2) That the counterparty has elected not to clear a particular swap under section 2h(7) of the Act and § 39.6 of this chapter;

(3) That the counterparty is a non-financial entity, as defined in section 2h(7)(C) of the Act;

(4) That the counterparty is hedging or mitigating a commercial risk; and

(5) That the counterparty generally meets its financial obligations associated with non-cleared swaps.

(b) *Recordkeeping.* Each swap dealer and major swap participant shall maintain all documents required to be obtained pursuant to this section in accordance with § 1.31 of this chapter and shall make them available promptly upon request to any representative of the Commission or any applicable prudential regulator, or with regard to swaps defined in section 1a(47)(A)(v) of

the Act, to any representative of the Commission, the Securities and Exchange Commission, or any applicable prudential regulator.

Issued in Washington, DC on January 13, 2011 by the Commission.

David A. Stawick,

Secretary of the Commission.

Appendices to Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants—Commissioners Voting Summary and Statements of Commissioners

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendix 1—Commissioners Voting Summary

On this matter, Chairman Gensler and Commissioners Dunn, Sommers, Chilton and O'Malia voted in the affirmative; no Commissioner voted in the negative.

Appendix 2—Statement of Chairman Gary Gensler

I support the proposed rulemaking that establishes swap trading relationship documentation requirements for swap dealers and major swap participants. The proposed regulations are consistent with the express mandate of the Dodd-Frank Act to prescribe standards for the timely and accurate confirmation, processing, netting, documentation and valuation of swap transactions. One of the primary goals of the Dodd-Frank Act was to establish a comprehensive regulatory framework that would reduce risk, increase transparency and promote market integrity within the financial system. The proposed regulations accomplish this objective by establishing procedures that will promote legal certainty regarding terms of swap transactions, early resolutions of valuation disputes, enhanced understanding of one counterparty's risk exposure to another, reduced operational risk and increased operational efficiency. One of the key chapters from the 2008 financial crisis was when large financial players, including AIG, had valuation disputes and other problems regarding documentation standards. These rules will directly address many of these issues, highlighting issues for senior management and regulators earlier and lowering risk to the public.

Appendix 3—Commissioner Scott D. O'Malia

I respectfully dissent from the Commission's decision to propose requirements regarding the inclusion of Title II of the Dodd-Frank Act (Title II) and the Federal Deposit Insurance Act (FDIA) in the swap documentation used by swap dealers (Dealers) and major swap participants (MSP). This proposal would require Dealers and MSP to include a provision in their swap documentation which will prevent their counterparties from exercising certain private, contractual rights in the event that a swap becomes subject to the processes of either Title II or FDIA. In particular, the proposal requires counterparties to explicitly consent to the resolution processes set forth in Title II or FDIA, which includes a one-day stay on the termination, liquidation or netting of swaps with a "covered financial company" as that term is defined under Title II. Title II also provides the Federal Deposit Insurance Company (FDIC) with an unchecked authority to repudiate contracts and preference which creditors receive payments. Finally, the proposal asks whether swap agreements which contain cross default provisions should also subject counterparty affiliates to a "covered financial company" designation or treat them as an insured depository institution under FDIA.

The Commission's proposal relies on its authorities in Title VII of the Dodd-Frank Act regarding swap documentation. Asking parties to agree upon and include valuation language in their swap agreements under this authority is one thing, but dictating that one party forego its legal contractual rights simply because its counterparty becomes subject to an overly vague and far reaching statute intended to address "systemic risk to the financial system" is quite another. If the FDIC authority to require this provision under Title II was clear, then there would be no need for the Commission to prop up the banking regulator's ability to exercise its resolution authority. In its best attempt to justify the proposal, the Commission claims that it is merely trying to put counterparties on notice of the already existing requirements of Title II and FDIA, but neither the proposal regarding an explicit consent to transfer, nor the discussion regarding affiliates and cross default agreements is a reflection of language already included in Title II or FDIA. At the very least, if the CFTC had any specific role under Title II or FDIA, then it would be clear how we would inform the treatment of the market participants that we regulate and their transactions in the case of a default. We do not.

By raising these objections, I hope that market participants will become fully aware of the legal regime that they will be subject to by virtue of entering into a swap agreement. I don't believe it is in our best interest to adopt seemingly redundant and unnecessary requirements into our regulations or to adopt requirements under the guise of our Title VII authorities that clearly exceeds the already broad statutory authority Congress decided to provide the FDIC under both Title II and FDIA. As a result, I cannot support this proposal.

[FR Doc. 2011–2643 Filed 2–7–11; 8:45 am]

BILLING CODE 6351–01–P

DELAWARE RIVER BASIN COMMISSION

18 CFR Part 410

Proposed Amendments to the Water Quality Regulations, Water Code and Comprehensive Plan To Provide for Regulation of Natural Gas Development Projects

AGENCY: Delaware River Basin Commission.

ACTION: Proposed rule; supplemental notice of public hearing.

SUMMARY: The Delaware River Basin Commission published in the **Federal Register** of January 4, 2011 a proposed rule containing tentative dates and locations for public hearings on proposed amendments to its Water Quality Regulations, Water Code and Comprehensive Plan relating to natural gas development projects. The public hearing dates have been changed and locations and times established, as set forth below.

DATES: Public hearings will be held at two locations on February 22, 2011 and at a third on February 24, 2011. Hearings will run from 1:30 p.m. until 5 p.m. and from 6 p.m. until 9:30 p.m. at each location. Written comments will be accepted through the close of business on March 16, 2011.

Locations: The hearings on February 22, 2011 will take place in the Honesdale High School auditorium, 459 Terrace Street, Honesdale, Pennsylvania and the Liberty High School auditorium, 125 Buckley Street, Liberty, New York. The hearings on February 24, 2011 will take place in Patriots Theater at the War Memorial, 1 Memorial Drive, Trenton, New Jersey.

FOR FURTHER INFORMATION CONTACT: Ms. Paula Schmitt at 609–883–9500, ext. 224.

SUPPLEMENTARY INFORMATION: This document supplements the Commission's proposed rule published in the **Federal Register** of January 4, 2011 (76 FR 295) by providing the dates, times and locations of the public hearings to be held on proposed amendments to the Commission's Water Quality Regulations, Water Code and Comprehensive Plan relating to the conservation and development of water resources of the Delaware River Basin during the implementation of natural gas development projects. The tentative hearing dates published in the notice of January 4, 2011 have been changed. The exact locations and times of the public hearings were not included in the January 4 notice and are provided here.