

third-party research report" shall mean a research report, in respect of which the person or entity producing the report:

(1) Has no affiliation or business or contractual relationship with the distributing swap dealer or major swap participant, or that swap dealer's or major swap participant's affiliates, that is reasonably likely to inform the content of its research reports; and
(2) makes content determinations without any input from the distributing swap dealer or major swap participant or that swap dealer's or major swap participant's affiliates.

(B) Subject to paragraph (c)(5)(iv)(C) of this section, if a swap dealer or major swap participant distributes or makes available any independent third-party research report, the swap dealer or major swap participant must accompany the research report with, or provide a Web address that directs the recipient to, the current applicable disclosures, as they pertain to the swap dealer or major swap participant, required by this section. Each swap dealer and major swap participant must establish written policies and procedures reasonably designed to ensure the completeness and accuracy of all applicable disclosures.

(C) The requirements of paragraph (c)(5)(iv)(B) of this section shall not apply to independent third-party research reports made available by a swap dealer or major swap participant to its customers:

(1) Upon request; or
(2) through a Web site maintained by the swap dealer or major swap participant.

(6) *Prohibition of Retaliation Against Research Analysts.* No swap dealer or major swap participant, and no employee of a swap dealer or major swap participant who is involved with the swap dealer's or major swap participant's pricing, trading or clearing activities, may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the swap dealer or major swap participant or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made, in good faith, by the research analyst that may adversely affect the swap dealer's or major swap participant's present or prospective pricing, trading or clearing activities.

(d) *Clearing activities.* (1) No swap dealer or major swap participant shall directly or indirectly interfere with or attempt to influence the decision of any affiliated clearing member of a derivatives clearing organization with

regard to the provision of clearing services and activities, including but not limited to:

(i) Whether to offer clearing services and activities to customers;

(ii) Whether to accept a particular customer for the purposes of clearing derivatives;

(iii) Whether to submit a transaction to a particular derivatives clearing organization;

(iv) Setting risk tolerance levels for particular customers;

(v) Determining acceptable forms of collateral from particular customers; or
(vi) Setting fees for clearing services.

(2) Each swap dealer and major swap participant shall create and maintain an appropriate informational partition, as specified in section 4s(j)(5)(A) of the Act, between business trading units of the swap dealer or major swap participant and clearing member personnel of any affiliated clearing member of a derivatives clearing organization. At a minimum, such informational partitions shall require that no employee of a business trading unit of a swap dealer or major swap participant shall supervise, control, or influence any employee of a clearing member of a derivatives clearing organization.

(e) *Undue Influence on Counterparties.* Each swap dealer and major swap participant must adopt and implement written policies and procedures that mandate the disclosure to its counterparties of any material incentives and any material conflicts of interest regarding the decision of a counterparty:

(1) Whether to execute a derivative on a swap execution facility or designated contract market, or

(2) Whether to clear a derivative through a derivatives clearing organization.

(f) All records that a swap dealer or major swap participant is required to maintain pursuant to this regulation shall be maintained in accordance with 17 CFR 1.31 and shall be made available promptly upon request to representatives of the Commission and to representatives of the applicable prudential regulator, as defined in 7 U.S.C. 1a(39).

Issued in Washington, DC, on November 10, 2010, by the Commission.

David A. Stawick,

Secretary of the Commission.

Statement of Chairman Gary Gensler

Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants

I support the proposed rulemakings that establish firewalls to ensure a separation

between the research arm, the trading arm and the clearing activities of swap dealers, major swap participants, futures commission merchants and introducing brokers. This rule proposal relates to the conflicts-of-interest provisions of the Dodd-Frank Act that direct swap dealers and major swap participants to have appropriate informational partitions. The proposal builds upon similar protections in the securities markets as mandated in the Sarbanes-Oxley Act. The proposed rules will protect market participants and the public while also promoting the financial integrity of the marketplace.

[FR Doc. 2010-29006 Filed 11-22-10; 8:45 am]

BILLING CODE 6351-01-P

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 23

RIN 3038-AC96

Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission is proposing regulations to implement new statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed regulations set forth certain duties imposed upon swap dealers and major swap participants registered with the Commission with regard to: Risk management procedures; monitoring of trading to prevent violations of applicable position limits; diligent supervision; business continuity and disaster recovery; disclosure and the ability of regulators to obtain general information; and antitrust considerations. The proposed regulations would implement the new statutory framework of section 4s(j) of the Commodity Exchange Act, added by section 731 of the Dodd-Frank Act, excepting regulations related to conflicts of interest pursuant to section 4s(j)(5), which will be addressed in a separate rulemaking. These regulations set forth certain duties with which swap dealers and major swap participants must comply to maintain registration as a swap dealer or major swap participant.

DATES: Submit comments on or before January 24, 2011.

ADDRESSES: You may submit comments, identified by RIN number 3038-AC96 and Duties of 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 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 procedures established in CFTC Regulation 145.9, 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 Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).¹ Title VII of the

Dodd-Frank Act² 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 rulemaking and enforcement authorities of the Commodity Futures Trading Commission (Commission or CFTC) 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 inserting after section 4r a new section 4s that sets forth registration and regulatory requirements, including a variety of business conduct standards and duties, with which swap dealers and major swap participants must comply to maintain registration as a swap dealer or major swap participant.

As part of an overall business conduct regime for swap dealers and major swap participants, section 4s(j) of the CEA sets forth certain duties for swap dealers and major swap participants, including the duty to: (1) Monitor trading to prevent violations of applicable position limits; (2) establish risk management procedures adequate for managing the day-to-day business of the swap dealer or major swap participant; (3) disclose to the Commission and to applicable prudential regulators⁴ general information relating to swaps trading, practices, and financial integrity; (4) establish and enforce internal systems and procedures to obtain information needed to perform all of the duties prescribed by Commission regulations; (5) implement conflict-of-interest systems and procedures;⁵ and (6)

¹ 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 This term is defined for the purposes of this rulemaking and generally has the same meaning as section 1(a)(39) of the Commodity Exchange Act, which includes the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Association, and the Federal Housing Finance Agency.

⁵ Conflicts of interest under section 4s(j)(5) of the CEA will be addressed in a separate rulemaking and the rules pertaining to conflicts of interest are not included in the following proposed rules.

refrain from taking any action that would result in an unreasonable restraint of trade or impose a material anticompetitive burden on trading or clearing. In this release, the Commission is proposing six regulations specifically addressing risk management, monitoring of positions limits, diligent supervision, business continuity and disaster recovery, the availability of general information, and antitrust considerations. The Commission would adopt these implementing regulations pursuant to authority granted under sections 4s(h)(1)(D), 4s(h)(3)(D), 4s(j)(7), and 8a(5) of the CEA.⁶ The Dodd-Frank Act requires the Commission to promulgate these provisions by July 15, 2011.

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.

The Commission requests comment on all aspects of the proposed regulations, as well as comment on the specific provisions and issues highlighted in the discussion below. The Commission further requests comment on an appropriate effective date for final regulations, including comment on whether it would be appropriate to have staggered or delayed effective dates for some regulations based on the nature or characteristics of the activities or entities to which they apply. Moreover, 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 or major swap participants.

II. Proposed Regulations

A. Structure and Approach

The proposed regulations set forth business conduct standards with which swap dealers and major swap participants must comply. Such duties

⁶ Section 8a(5) of the CEA authorizes the Commission, to promulgate such regulations as, in the judgement of the Commission, are reasonably necessary to effectuate any of the provisions or to accomplish any of the purposes of the CEA.

¹ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124

are outlined in section 4s(j) of the CEA and include: (1) Monitoring of trading; (2) risk management procedures; (3) disclosure of general information; (4) ability to obtain information; (5) conflicts of interest; and (6) antitrust considerations. Section 4s(j)(7) requires the Commission to prescribe rules implementing the enumerated duties.

The proposed regulations will be grouped under a new subpart to part 23, chapter I, title 17 of the Code of Federal Regulations. The proposed regulations generally address monitoring of trading and risk management together in a single rule requiring each swap dealer and major swap participant to establish a comprehensive risk management program (rule 23.600). Although part of a comprehensive risk management program, monitoring of trading for compliance with applicable position limits (rule 23.601); diligent supervision of a swap dealer's or major swap participant's business (rule 23.602); and business continuity and disaster recovery requirements (rule 23.603) are addressed in separate rules for ease of reference. The availability for disclosure and inspection of general information (rule 23.606) and antitrust considerations (rule 23.607) also are addressed in separate rules. Conflicts of interest under section 4s(j)(5) of the CEA (rule 23.605) will be addressed in a separate notice of proposed rulemaking to be released at the same time as this proposal.

B. Risk Management

1. Overview

Sections 4s(h)(1)(D), 4s(h)(3)(D), and 4s(j) of the CEA authorize the Commission to adopt those regulations regarding business conduct and risk management that the Commission deems necessary for the public interest and in furtherance of the CEA. Pursuant to this authority, the Commission is proposing regulation 23.600 to require swap dealers and major swap participants to establish a risk management program for monitoring and managing the risks associated with their business activities.

The proposed risk management regulation contemplates that each legal entity that falls within the definition of swap dealer or major swap participant under the CEA and Commission regulations would be required to establish a risk management program and risk management unit. However, the Commission recognizes that the business activities engaged in and risks faced by one affiliate may increase the risk exposure or alter overall risk profile of another affiliate or the entity as a

whole, and that, to be effective, a risk management program must protect against the risks resulting from the activities of interconnected or otherwise related entities. Accordingly, the proposed regulations would require each swap dealer and major swap participant to be able to demonstrate that, to the extent possible, it is taking an integrated approach to risk management at the consolidated entity level.

Participants in the swap markets are exposed to various risks, including, but not limited to: (1) Market risk;⁷ (2) credit risk;⁸ (3) liquidity risk;⁹ (4) foreign currency risk;¹⁰ (5) legal risk;¹¹ (6) operational risk;¹² and (7) settlement risk.¹³ Managing all relevant risks should be integrated into the swap dealer and major swap participant's overall risk management structure. The Commission believes this approach is particularly warranted given that swap dealers and major swap participants may hold positions in a variety of financial instruments.

Some of these risks are due, in part, to the characteristics of swap products and the way swap markets have evolved over time. For example, some swaps are customized or designed with unique characteristics that may present previously unforeseen or unpredictable risks. Also, for swaps not accepted for clearing, market participants face risks associated with the financial and legal ability of counterparties to perform under the terms of specific transactions. As part of a risk management program, risk managers must carefully review any unique product characteristics that may

⁷ Market risk includes the risk that prices or rates will adversely change due to economic forces. This risk includes, among other things, changes in correlations between or among products (including all types of basis risk), volatility of market prices, and the sensitivity of option positions to other market factors.

⁸ Credit risk includes the risk that a counterparty will be unable to meet fully its financial obligations when due or at any time in the future.

⁹ Liquidity risk includes the risk that a firm will not be able to settle its obligations when due and/or without adverse price changes.

¹⁰ Foreign currency risk is the risk arising from movements of foreign exchange rates.

¹¹ Legal risk includes risk of loss due to an unenforceable contract, an ultra vires act of a counterparty, or failure to comply with applicable law.

¹² Operational risk includes the risk of loss due to deficiencies in information systems, internal processes and staffing, or disruptions from external events that result in the reduction, deterioration, or breakdown in services or controls within the firm.

¹³ Settlement risk includes the risk of loss arising when a party meets its payment obligation under a contract before its counterparty meets its payment obligation. Settlement risk lasts from the time an outgoing payment instruction can no longer be canceled unilaterally until the time the incoming payment is received with finality and reconciled.

pose unusual risks and take steps to manage potential risks before trading commences.

In the past, the importance of risk management has been highlighted by significant losses experienced by several large financial firms. Some of these losses were caused by unauthorized and undisclosed employee trading. In each case, these losses went virtually undetected by management because of the lack of proper internal procedures, including the separation of responsibility for recording the trades on the firms' books from the personnel responsible for trading. Internal risk management policies and procedures promote the stability, safety, and soundness of firms by reducing the risk of significant losses, which, in turn, may reduce the risk that spreading losses would cause defaults by multiple firms, thereby undermining markets as a whole.

The Commission recognizes that an individual firm must have the flexibility to implement specific policies and procedures unique to its circumstances. The Commission's rule has been designed such that the specific elements of a risk management program will vary depending on the size and complexity of a swap dealer's or major swap participant's business operations. Risk management policies are expected to provide for appropriate risk measurement methodologies, compliance monitoring and reporting, and on-going testing and assessment of the overall effectiveness of the program. Consequently, proposed regulations 23.600, 23.601, 23.602, and 23.603 would establish the general parameters for the design, implementation, review, and testing of a swap dealer's or major swap participant's risk management program, as well as a limited number of additional elements that the Commission believes are essential to an appropriate risk management program.

The proposed rules would require a swap dealer or major swap participant to adopt policies and procedures to monitor and manage its risks, assess the effectiveness of those policies and procedures, and modify or update them, as necessary, from time to time. In addition, the proposed rule would require certain elements to be included in each swap dealer and major swap participant's risk management program to ensure that internal systems protect against universal risks. For example, to ensure the independence of the risk management process, the unit at the firm responsible for monitoring risk must be independent from the business trading unit whose activities create the risks. In addition, to ensure that trading

losses cannot be hidden, personnel responsible for recording transactions in the books of the swap dealer or major swap participant cannot be the same as those responsible for executing transactions. Similarly, all accounts, including suspense accounts, must be monitored.

Finally, the swap dealer's or major swap participant's management must periodically review the firm's business activities for consistency with established risk management policies. This will ensure that personnel are operating within the scope of activity that management has determined to be permissible.

2. Risk Management Program

Proposed regulation 23.600(b) provides a general requirement that a swap dealer or major swap participant establish and maintain a risk management program reasonably designed to monitor and manage the risks associated with its business as a swap dealer or major swap participant. It further provides (1) That such risk management program consist of written policies and procedures; (2) that such policies and procedures be approved by the governing body of the swap dealer or major swap participant and be furnished to the Commission; and (3) that a risk management unit that is independent from the business trading unit be established to administer the risk management program.

The proposed regulations would require swap dealers and major swap participants to provide copies of the risk management policies and procedures to the Commission in order to allow the Commission to monitor the status of risk management practices among swap dealers and major swap participants. Submission of such policies and procedures to the Commission without further comment or action by the Commission or Commission staff should not be construed as an endorsement of the completeness or effectiveness of the risk management policies and procedures and no swap dealer or major swap participant should make a representation to the contrary. The Commission invites comments on the submission of risk management policies and procedures and, more generally, on whether the provisions of 23.600 have achieved a sufficient level of detail for the purposes of designing a comprehensive risk management program.

Proposed regulation 23.600(c) would provide a non-exclusive list of the elements that must be a part of the risk management program of a swap dealer or major swap participant. Such policies

and procedures should include: (1) Identifying risks and setting of risk tolerance limits; (2) providing periodic risk exposure reports to senior management and the governing body; (3) establishing a new product policy; and (4) establishing a risk management program that takes into account market risk, credit risk, liquidity risk, foreign currency risk, legal risk, operational risk, and settlement risk, including a process for evaluating and addressing risks associated with the use of models to derive market valuations or otherwise calculate or evaluate risk exposures. The regulation also would establish requirements for supervision of the business unit of a swap dealer or major swap participant, including monitoring of limits on individual traders and establishing procedures governing the use, supervision, and testing of any algorithmic trading program. The objective is to ensure that those capable of committing the capital of the swap dealer or major swap participant are properly supervised and subject to approved limits. Additionally, the risk management program should set forth requirements for compliance with Commission regulations related to capital and margin and for monitoring overall compliance with the risk management program. The rule also would require that swap dealers and major swap participants establish policies and procedures (1) to require the use of central counterparties for clearing where clearing is required pursuant to Commission regulation or order, and (2) to use central clearing as a means of mitigating counterparty credit risk.

To ensure the continued effectiveness of a risk management program, proposed regulation 23.600(e) would require quarterly review and testing of the adequacy of each swap dealer and major swap participant's risk management program by internal audit staff or a qualified external, third party service. The Commission requests comment on these proposed audit and review requirements.

C. Monitoring of Position Limits

Proposed regulation 23.601 would require swap dealers and major swap participants to establish policies and procedures to monitor, detect, and prevent violations of applicable position limits established by the Commission, a designated contract market, or a swap execution facility. This rule implements section 4s(j)(1) of the CEA, which requires each swap dealer and major swap participant to monitor its trading in swaps to prevent violations of applicable position limits. In order to

prevent violations, each swap dealer and major swap participant would be required to provide training to all relevant employees on applicable position limits, actively monitor trading, implement an early warning system, test the effectiveness of its policies and procedures, and report quarterly to its senior management and governing body on compliance with applicable position limits. The Commission requests comment on how much time would be needed for swap dealers and major swap participants to come into compliance with new position limits that may be imposed.

D. Diligent Supervision

Proposed regulation 23.602 implements section 4s(h)(1)(B) of the CEA, which requires each swap dealer and major swap participant to conform with Commission regulations related to diligent supervision of the business of the swap dealer and major swap participant. The proposed regulation provides (1) a requirement for diligent supervision reasonably designed to achieve compliance with the CEA and Commission regulations, and (2) requirements for qualification of supervisors and grants of appropriate supervisory authority.

E. Business Continuity and Disaster Recovery

Given the observed interconnectedness of the current swap market, and as part of a comprehensive risk management program, the Commission believes that each swap dealer and major swap participant should be required to establish and maintain a business continuity and disaster recovery plan that is reasonably designed to minimize any disruption to the financial markets in the event of an emergency or a disruption of a swap dealer's or major swap participant's business operations. Proposed regulation 23.603 would require swap dealers and major swap participants to establish and maintain a business continuity and disaster recovery plan designed to enable the swap dealer or major swap participant to resume normal operations within one business day of an emergency or other disruption.

To accomplish this task, swap dealers and major swap participants would be required to provide the Commission with emergency contacts; identify essential documents, data, facilities, infrastructure, and personnel, and maintain sufficient back-up facilities in a reasonably separate geographic location; design a plan for communicating with persons essential

for recovery; and annually test the business continuity and disaster recovery plan's effectiveness.

The Commission invites comments regarding whether a comprehensive business continuity and disaster recovery plan is necessary for all entities that may register with the Commission as swap dealers or major swap participants and whether one business day is sufficient time for recovery of essential business operations. The Commission also invites comments regarding an appropriate effective date for this regulation given the amount of time and cost that may be necessary for implementation of a comprehensive business continuity and disaster recovery plan.

F. Disclosure and Ability To Obtain Information

In order to carry out its oversight and examination responsibilities, the Commission would require access to certain information of swap dealers and major swap participants.¹⁴ Sections 4s(j)(3) and 4s(j)(4) of the CEA require a swap dealer or major swap participant to (1) disclose to the Commission and to the swap dealer's or major swap participant's prudential regulator information regarding the terms and conditions of its swaps, its swap trading operations, mechanisms, and practices; its financial integrity protections relating to swaps, and other information relevant to its trading in swaps; and (2) establish internal systems to obtain necessary information to perform any of the functions described in section 4s and for disclosure of information to the Commission or prudential regulator upon request. Proposed regulation 23.606 would implement these requirements.

Proposed regulation 23.606(a) requires that swap dealers and major swap participants make available for disclosure and inspection all information required by the Commission, including those items listed in section 4s(j)(3). This information would be required to be disclosed promptly to the Commission or applicable prudential regulator in the manner and frequency as set forth in the relevant regulation. Proposed regulation 23.606(b) would require a swap dealer or major swap participant to establish

and maintain adequate internal systems that will permit it to obtain any information required to satisfy its duties under section 4s(j) of the CEA.

G. Antitrust Considerations

Section 4s(j)(6) of the CEA prohibits a swap dealer or major swap participant from adopting any process or taking any action that results in any unreasonable restraint of trade or imposes any material anticompetitive burden on trading or clearing, unless necessary or appropriate to achieve the purposes of the CEA. Proposed regulation 23.607 would implement these prohibitions by requiring that the swap dealer or major swap participant adopt policies and procedures that would prevent unreasonable restraint of trade or the imposition of a material anticompetitive burden on trading or clearing.

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.¹⁵ The Commission previously has established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its regulations on small entities in accordance with the RFA.¹⁶ 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. However, the Commission previously has determined that futures commission merchants should not be considered to be small entities for purposes of the RFA.¹⁷ 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.¹⁸ 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 has also previously determined that large traders are not "small entities" for RFA purposes.¹⁹ 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 risks 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)²⁰ imposes certain requirements on Federal agencies 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

¹⁴ The oversight, supervision, and examination regimes for swap dealers and major swap participants remain under consideration by the Commission. The Commission is considering whether it will directly handle oversight, whether it may delegate authority to perform oversight to one or more self-regulatory organizations (SROs), or whether a combination of Commission and SRO oversight would be the optimal approach.

¹⁵ 5 U.S.C. 601 *et seq.*

¹⁶ 47 FR 18618, Apr. 30, 1982.

¹⁷ *Id.* at 18619.

¹⁸ *Id.*

¹⁹ *Id.* at 18620.

²⁰ 44 U.S.C. 3501 *et seq.*

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 "Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants." The OMB has not yet assigned this collection a control number. 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 collection of information under these proposed rules is necessary to implement certain provisions of the CEA, as amended by the Dodd-Frank Act. Specifically, it is essential to ensuring that swap dealers and major swap participants maintain risk management programs, business continuity and disaster recovery plans, procedures to ensure compliance with position limits, and antitrust procedures. Commission staff would use the information when conducting the Commission's examination and oversight program to evaluate the completeness and effectiveness of the procedures adopted by the registrants.

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 is also 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

The proposed regulation would require each swap dealer and major swap participant to establish a risk management program (including specific policies for compliance with position limits and to ensure business continuity and disaster recovery); establish policies to prevent unreasonable restraints of trade and anticompetitive burdens; establish systems to diligently supervise the activities relating to its business; and make certain information available for

disclosure and inspection by the Commission. These requirements may impose PRA burdens. The burden associated with the proposed regulation per registrant is estimated to be 204.5 hours per year, at an annual cost of \$20,450. For purposes of the PRA, the term "burden" means the "time, effort, or financial resources expended by persons to generate, maintain, or provide information to or for a Federal Agency."²¹ This burden will result from the development of the required policies and procedures, satisfaction of various reporting obligations and the documentation of required testing.

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 that there may likely 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 establish and implement risk management policies and procedures under the proposed rules. The Commission estimated the number of affected entities based on industry data.

According to recent Bureau of Labor Statistics, the mean hourly wage of an employee under occupation code 11-3031, "Financial Managers," (which includes financial risk managers) that is employed by the "Securities and Commodity Contracts Intermediation and Brokerage" industry is \$74.41.²² Because swap dealers and major swap participants include large financial institutions whose risk management employees' salaries may exceed the mean wage, the Commission has estimated the cost burden of these proposed regulations based upon an average salary of \$100 per hour. Accordingly, the estimated burden was calculated as follows:

Drafting, Filing, Updating and Distributing Risk Management Program (Including Position Limit Procedures and Business Continuity and Disaster Recovery Plan)

Number of registrants: 300.
Estimated number of responses: 300.
Estimated total annual burden per registrant: 160 hours.

²¹ 44 U.S.C. 3502(2).

²² <http://www.bls.gov/oes/current/oes113031.htm>.

Frequency of collection: One-time filing with the Commission, annual distribution, updating as needed.

Total annual burden: 48,000 burden hours [300 registrants × 160 hours].

Quarterly Risk Exposure Reports

Number of registrants: 300.
Estimated number of responses: 1,200 [300 registrants × 4 reports].
Estimated total annual burden per registrant: 32 hours.

Frequency of collection: Quarterly.
Total annual burden: 9,600 burden hours [300 registrants × 32 hours].

Quarterly Documentation of Risk Management Testing

Number of registrants: 300.
Estimated number of responses: 1,200 [300 registrants × 4 tests].
Estimated total annual burden per registrant: 4 hours.

Frequency of collection: Quarterly.
Total annual burden: 1,200 hours [300 registrants × 4 hours].

Documentation of Annual Position Limit Compliance Training and Audit

Number of registrants: 300.
Estimated number of responses: 300.
Estimated total annual burden per registrant: 2 hours.

Frequency of collection: Annually.
Total annual burden: 600 hours [300 registrants × 2 hours].

Quarterly Documentation of Position Limit Compliance

Number of registrants: 300.
Estimated number of responses: 1,200 [300 registrants × 4 reports].
Estimated total annual burden per registrant: 2 hours.

Frequency of collection: Quarterly.
Total annual burden: 600 hours [300 registrants × 2 hours].

Documentation of Position Limit Violations

Number of registrants: 300.
Estimated number of responses: 600 [300 registrants × 2 documents].
Estimated total annual burden per registrant: .5.

Frequency of collection: As needed.
Total annual burden: 150 hours [300 registrants × .5 hours].

Filing Emergency Contact Information and Annual Documentation of Business Continuity Testing

Number of registrants: 300.
Estimated number of responses: 300.
Estimated total annual burden per registrant: 1 hour.
Frequency of collection: Annual.
Total annual burden: 300 hours.

Documentation of Risk Assessment of New Products

Number of registrants: 300.

Estimated number of responses: 1,500 [300 registrants × 5 documents].

Estimated total annual burden per registrant: 3 hours.

Frequency of collection: As needed.

Total annual burden: 900 hours [300 registrants × 3 hours].

Based upon the above, the aggregate cost for all registrants is 61,350 burden hours and \$6,135,000 [61,350 × \$100 per hour].

2. Information Collection Comments

The Commission invites the public and other federal agencies to comment on any aspect of the reporting and recordkeeping burdens discussed above. 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 <http://www.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 (and the Commission) receives it within 30 days of publication.

C. Cost-Benefit Analysis

Section 15(a) of the CEA²³ 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 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 certain provisions of section 731 of the Dodd-Frank Act, which adds a new section 4s(j) to the Commodity Exchange Act. The proposed regulations would set forth certain duties imposed upon swap dealers and major swap participants registered with the Commission with regard to: (1) Risk management procedures; (2) monitoring of trading to prevent violations of applicable position limits; (3) diligent supervision; (4) business continuity and disaster recovery; (5) disclosure and the ability of regulators to obtain general information; and (6) antitrust considerations.

Costs. With respect to costs, the Commission has determined that for swap dealers and major swap participants, costs to institute risk management systems and personnel in order to satisfy the new regulatory requirements are far outweighed by the benefits to the financial system as a whole. The proposed rules would require a swap dealer or major swap participant to consider a number of issues affecting its business environment when creating its risk management system. For example, a swap dealer or major swap participant

would need to consider, among other things, the experience and qualifications of relevant risk management personnel, as well as the separation of duties among personnel in the business unit, when designing and implementing its risk management policies and procedures. These considerations would help facilitate the development of a risk management program that appropriately addresses the risks posed by the swap dealer's or major swap participant's business and the environment in which such business is being conducted. In addition, these considerations would guide a swap dealer or major swap participant in the implementation of specific policies and procedures unique to its circumstances.

It is estimated that the average amount of time a swap dealer or major swap participant would spend annually implementing its comprehensive risk management program would be 204.5 hours. Based on an hourly wage rate of \$100, Commission staff estimates that each registrant could expend up to \$20,450 annually to comply with the proposed rules. This would result in an aggregated cost of \$6,135,000 annually (300 registrants × \$20,450).

Most swap dealers and major swap participants have adequate resources and existing risk management structures that are capable of adjusting to the new regulatory framework without material diversion of resources away from commercial operations.

Benefits. With respect to benefits, the proposed regulations would require swap dealers and major swap participants to assess and monitor the adequacy of their risk management under standards established by the Commission. This would further the goal of avoiding market disruptions and financial losses to market participants and the general public. The proposed regulations also would promote prudent risk management, oversight and stability, thereby fostering efficiency and a greater ability to compete in the broader financial markets. The proposed regulations would reward efficiency insofar as swap dealers and major swap participants that operate efficiently would have lower operating costs and thus would require fewer resources to comply with the regulations. Finally, the proposed regulations are designed to ensure that swap dealers and major swap participants can sustain their market operations and meet their financial obligations to market participants, thus contributing to the integrity of the financial markets. Therefore, the Commission believes it is prudent to require risk management

²³ 7 U.S.C. 19(a).

requirements for swap dealers and major swap participants.

Public Comment. The Commission invites public comment on its cost-benefit considerations. Commenters 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 in a separate proposed rule published elsewhere in this issue of the **Federal Register**) as follows:

PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS

Authority and Issuance

1. The authority citation for part 23 continues 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. Subpart J is added to read as follows:

Subpart J—Duties of Swap Dealers and Major Swap Participants

Sec.

23.600 Risk Management Program for swap dealers and major swap participants.

23.601 Monitoring of position limits.

23.602 Diligent supervision.

23.603 Business continuity and disaster recovery.

23.604 [Reserved]

23.605 [Reserved]

23.606 General information: Availability for disclosure and inspection.

23.607 Antitrust considerations.

Subpart J—Duties of Swap Dealers and Major Swap Participants

§ 23.600 Risk Management Program for swap dealers and major swap participants.

(a) *Definitions.* For purposes of this subpart J, the following terms shall be defined as provided.

(1) *Affiliate.* This term means, with respect to any person, a person controlling, controlled by, or under common control with, such person.

(2) *Business trading unit.* This term means any department, division, group, or personnel of a swap dealer or major swap participant or any of its affiliates, whether or not identified as such, that performs or is involved in any pricing, trading, sales, marketing, advertising, solicitation, structuring, or brokerage activities on behalf of a registrant.

(3) *Clearing unit.* This term means any department, division, group, or personnel of a registrant or any of its affiliates, whether or not identified as such, that performs any proprietary or customer clearing activities on behalf of a registrant.

(4) *Governing body.* This term typically means, with respect to:

(i) A sole proprietorship, the proprietor;

(ii) A corporation, its board of directors;

(iii) A partnership, any general partner;

(iv) A limited liability company or limited liability partnership, the manager, managing member or those members vested with management authority; or

(v) Any other person, the body or person with ultimate decision-making authority over the activities of such person.

(5) *Prudential regulator.* This term has the same meaning as section 1a(39) of the Commodity Exchange Act and includes the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Association, and the Federal Housing Finance Agency, as applicable to the swap dealer or major swap participant. The term also includes the Federal Deposit Insurance Corporation, with respect to any financial company as defined in section 201 of under the Dodd-Frank Wall Street Reform and Consumer Protection Act or any insured depository institution under the Federal Deposit Insurance Act, and with respect to each affiliate of any such company or institution.

(6) *Senior management.* This term means, with respect to a registrant, such registrant's chief executive officer and any officer with supervisory duties who reports directly to the chief executive officer.

(b) *Risk management program.*

(1) *Purpose.* Each swap dealer and major swap participant shall establish, document, maintain, and enforce a system of risk management policies and procedures designed to monitor and manage the risks associated with the business of the swap dealer or major swap participant. For purposes of this regulation, such policies and procedures shall be referred to collectively as a "Risk Management Program."

(2) *Written policies and procedures.* Each swap dealer and major swap participant shall maintain written policies and procedures that describe the Risk Management Program of the swap dealer or major swap participant.

(3) *Approval by governing body.* The Risk Management Program and the written risk management policies and procedures shall be approved, in writing, by the governing body of the swap dealer or major swap participant.

(4) *Furnishing to the Commission.*

Each swap dealer and major swap participant shall furnish a copy of its written risk management policies and procedures to the Commission upon application for registration. Where there is a material change in the risk management policies and procedures, updated risk management policies and procedures reflecting that change shall be furnished to the Commission within sixty (60) calendar days after the end of the fiscal quarter in which the change occurred.

(5) *Risk management unit.* As part of its Risk Management Program, each swap dealer and major swap participant shall establish and maintain a risk management unit with sufficient authority; qualified personnel; and financial, operational, and other resources to carry out the risk management program established pursuant to this regulation. The risk management unit shall report directly to senior management and shall be independent from the business trading unit.

(c) *Elements of the Risk Management Program.* The Risk Management Program of each swap dealer and major swap participant shall include, at a minimum, the following elements:

(1) *Identification of risks and risk tolerance limits.* (i) The Risk Management Program should take into account market, credit, liquidity, foreign currency, legal, operational, settlement, and any other applicable risks together with a description of the risk tolerance limits set by the swap dealer or major swap participant and the underlying methodology. The risk tolerance limits shall be reviewed and approved quarterly by senior management and annually by the governing body. Exceptions to risk tolerance limits shall require prior approval of, at a minimum, a supervisor in the risk management unit.

(ii) The Risk Management Program shall take into account risks posed by affiliates and take an integrated approach to risk management at the consolidated entity level.

(iii) The Risk Management Program shall include policies and procedures for detecting breaches of risk tolerance limits set by the swap dealer or major swap participant, and alerting supervisors within the risk management unit and senior management, as appropriate.

(2) *Periodic Risk Exposure Reports.*

(i) The risk management unit of each swap dealer and major swap participant shall provide to senior management and to its governing body quarterly written reports setting forth the market, credit, liquidity, foreign currency, legal, operational, settlement, and any other applicable risk exposures of the swap dealer or major swap participant; any recommended changes to the Risk Management Program; the recommended time frame for implementing those changes; and the status of any incomplete implementation of previously recommended changes to the Risk Management Program. For purposes of this regulation, such reports shall be referred to as "Risk Exposure Reports." The Risk Exposure Reports also shall be provided to the senior management and the governing body immediately upon detection of any material change in the risk exposure of the swap dealer or major swap participant.

(ii) *Furnishing to the Commission.* Each swap dealer and major swap participant shall furnish copies of its Risk Exposure Reports to the Commission within five (5) business days of providing such reports to its senior management.

(3) *New product policy.* The Risk Management Program of each swap dealer and major swap participant shall include a new product policy that is designed to identify and take into account the risks of any new product prior to engaging in transactions involving the new product. The new product policy should include the following elements:

(i) Consideration of the type of counterparty with which the new product will be transacted; the product's characteristics and economic function; and whether the product requires a novel pricing methodology or presents novel legal and regulatory issues.

(ii) Identification and analysis of the relevant risks of the new product and how they will be managed. The risk analysis should include an assessment of any product, market, credit, liquidity, foreign currency, legal, operational, settlement, and any other risks associated with the new product. Product risk characteristics may include, but are not limited to, volatility, non-linear price characteristics, jump-to-default risk, and any correlation between the value of the product and the counterparty's creditworthiness.

(iii) An assessment, signed by a supervisor in the risk management unit, as to whether the new product would materially alter the overall entity-wide

risk profile of the swap dealer or major swap participant. If the new product would materially alter the overall risk profile of the swap dealer or major swap participant, the new product must be pre-approved by the governing body before any transactions are effectuated.

(iv) A requirement that the risk management unit review the risk analysis to identify any necessary modifications to the Risk Management Program and implement such modifications prior to engaging in transactions involving the new product.

(4) *Specific risk management considerations.* The Risk Management Program of each swap dealer and major swap participant shall include, but not be limited to, policies and procedures necessary to monitor and manage the following risks:

(i) *Market risk.* Market risk policies and procedures shall take into account, among other things:

(A) Daily measurement of market exposure, including exposure due to unique product characteristics, volatility of prices, basis and correlation risks, leverage, sensitivity of option positions, and position concentration, to comply with market risk tolerance limits;

(B) Timely and reliable valuation data derived from, or verified by, sources that are independent of the business trading unit, and if derived from pricing models, that the models have been independently validated by qualified, independent persons; and

(C) Reconciliation of profits and losses resulting from valuations with the general ledger at least once each business day.

(ii) *Credit risk.* Credit risk policies and procedures shall take into account, among other things:

(A) Daily measurement of overall credit exposure to comply with counterparty credit limits;

(B) Monitoring and reporting of violations of counterparty credit limits performed by personnel that are independent of the business trading unit; and

(C) Regular valuation of collateral used to cover credit exposures and safeguarding of collateral to prevent loss, disposal, rehypothecation, or use unless appropriately authorized.

(iii) *Liquidity risk.* Liquidity risk policies and procedures shall take into account, among other things:

(A) Daily measurement of liquidity needs;

(B) Testing of procedures to liquidate all non-cash collateral in a timely manner and without significant effect on price; and

(C) Application of appropriate collateral haircuts that accurately reflect market and credit risk.

(iv) *Foreign currency risk.* Foreign currency risk policies and procedures shall take into account, among other things:

(A) Daily measurement of the amount of capital exposed to fluctuations in the value of foreign currency to comply with applicable limits; and

(B) Establishment of safeguards against adverse currency fluctuations.

(v) *Legal risk.* Legal risk policies and procedures shall take into account, among other things:

(A) Determinations that transactions and netting arrangements entered into have a sound legal basis; and

(B) Establishment of documentation tracking procedures designed to ensure the completeness of relevant documentation and to resolve any documentation exceptions on a timely basis.

(vi) *Operational risk.* Operational risk policies and procedures shall take into account, among other things:

(A) Secure and reliable operating and information systems with adequate, scalable capacity, and independence from the business trading unit;

(B) Safeguards to detect, identify, and promptly correct deficiencies in operating and information systems; and

(C) Reconciliation of all operating and information systems.

(vii) *Settlement risk.* Settlement risk policies and procedures shall take into account, among other things:

(A) Establishment of standard settlement instructions with each counterparty;

(B) Procedures to track outstanding settlement items and aging information in all accounts, including nostro and suspense accounts; and

(C) Procedures to ensure timely payments to counterparties and to resolve any late payments.

(5) *Use of central counterparties.* Each swap dealer and major swap participant shall establish policies and procedures relating to its use of central counterparties. Such policies and procedures shall:

(i) Require the use of central counterparties where clearing is required pursuant to Commission regulation or order, unless the counterparty has properly invoked a clearing exemption under Commission regulations;

(ii) Set forth the conditions for use of central counterparties for clearing when available as a means of mitigating counterparty credit risk; and

(iii) Require diligent investigation into the adequacy of the financial resources

and risk management procedures of any central counterparty through which the swap dealer or major swap participant clears.

(6) *Compliance with margin and capital requirements.* Each swap dealer and major swap participant shall satisfy all capital and margin requirements established by the Commission or prudential regulator, as applicable.

(7) *Monitoring of compliance with Risk Management Program.* Each swap dealer and major swap participant shall establish policies and procedures to detect violations of the Risk Management Program; to encourage employees to report such violations to senior management, without fear of retaliation; and to take specified disciplinary action against employees who violate the Risk Management Program.

(d) *Business trading unit.* Each swap dealer and major swap participant shall establish policies and procedures that, at a minimum:

(1) Require all trading policies be approved by the governing body of the swap dealer or major swap participant;

(2) Require that traders execute transactions only with counterparties for whom credit limits have been established;

(3) Provide specific quantitative or qualitative limits for traders and personnel able to commit the capital of the swap dealer or major swap participant;

(4) Monitor each trader throughout the trading day to prevent the trader from exceeding any limit to which the trader is subject, or from otherwise incurring undue risk;

(5) Require each trader to follow established policies and procedures for executing and confirming all transactions;

(6) Establish means to detect unauthorized trading activities or any other violation of policies and procedures;

(7) Ensure that trade discrepancies are brought to the immediate attention of management of the business trading unit and are documented;

(8) Ensure that the risk management unit reviews brokers' statements, reconciles brokers' charges to estimates, reviews and monitors broker's commissions, and initiates payment to brokers;

(9) Ensure that use of algorithmic trading programs is subject to policies and procedures governing the use, supervision, maintenance, testing, and inspection of the program; and

(10) Require the separation of personnel in the business trading unit

from personnel in the risk management unit.

(e) *Review and testing.* (1) Risk Management Programs shall be reviewed and tested on at least a quarterly basis, or upon any material change in the business of the swap dealer or major swap participant that is reasonably likely to alter the risk profile of the swap dealer or major swap participant.

(2) The quarterly reviews of the Risk Management Program shall include an analysis of adherence to, and the effectiveness of, the risk management policies and procedures, and any recommendations for modifications to the Risk Management Program. The quarterly testing shall be performed by qualified internal audit staff that are independent of the business trading unit being audited or by a qualified third party audit service reporting to staff that are independent of the business trading unit. The results of the quarterly reviews of the Risk Management Program shall be promptly reported to and reviewed by, the chief compliance officer, senior management, and governing body of the swap dealer or major swap participant.

(3) Each swap dealer and major swap participant shall document all internal and external reviews and testing of its Risk Management Program and written risk management policies and procedures including the date of the review or test; the results; any deficiencies identified; the corrective action taken; and the date that corrective action was taken. Such documentation shall be provided to Commission staff, upon request.

(f) *Distribution of risk management policies and procedures.* The Risk Management Program shall include procedures for the timely distribution of its written risk management policies and procedures to relevant supervisory personnel. Each swap dealer and major swap participant shall maintain records of the persons to whom the risk management policies and procedures were distributed and when they were distributed.

(g) *Recordkeeping.* (1) Each swap dealer and major swap participant shall maintain copies of all written approvals required by this section.

(2) All records or reports that a swap dealer or major swap participant is required to maintain pursuant to this regulation shall be maintained in accordance with 17 CFR 1.31 and shall be made available promptly upon request to representatives of the Commission and to representatives of applicable prudential regulators.

§ 23.601 Monitoring of position limits.

(a) Each swap dealer and major swap participant shall establish and enforce written policies and procedures that are designed to monitor for and prevent violations of applicable position limits established by the Commission, a designated contract market, or a swap execution facility, and to monitor for and prevent improper reliance upon any exemptions or exclusions from such position limits. For purposes of this regulation, such policies and procedures shall be referred to as "Position Limit Procedures." The Position Limit Procedures shall be incorporated into the Risk Management Program of the swap dealer or major swap participant.

(b) For purposes of the Position Limit Procedures, each swap dealer and major swap participant shall convert all swap positions into equivalent futures positions using the methodology set forth in Commission regulations.

(c) Each swap dealer and major swap participant shall provide training to all relevant personnel on applicable position limits on an annual basis and promptly upon any change to applicable position limits. Each swap dealer and major swap participant shall maintain records of such training including the substance of the training and the identity of those receiving training.

(d) Each swap dealer and major swap participant shall diligently monitor its trading activities and diligently supervise the actions of its partners, officers, employees, and agents to ensure compliance with the Position Limit Procedures of the swap dealer or major swap participant.

(e) The Position Limit Procedures of each swap dealer and major swap participant shall implement an early warning system designed to detect and alert its senior management when position limits are in danger of being breached (such as when trading has reached a percentage threshold of the applicable position limit, and when position limits have been exceeded). Any detected violation of applicable position limits shall be reported promptly to the firm's governing body and to the Commission. Each swap dealer and major swap participant shall maintain a record of any early warning received, any position limit violation detected, any action taken as a result of either, and the date action was taken.

(f) Each swap dealer and major swap participant shall test its Position Limit Procedures for adequacy and effectiveness each month and maintain records of such monthly tests; the results thereof; any action that is taken as a result thereof including, without limitation, any recommendations for

modifications to the firm's Position Limit Procedures; and the date action was taken.

(g) Each swap dealer and major swap participant shall document its compliance with applicable position limits established by the Commission, a designated contract market, or a swap execution facility in a written report on a quarterly basis. Such report shall be promptly reported to and reviewed by the chief compliance officer, senior management, and governing body of the swap dealer or major swap participant, and shall include, without limitation, a list of all early warnings received, all position limit violations, the action taken in response, the results of the monthly position limit testing required by this regulation, any deficiencies in the Position Limit Procedures, the status of any pending amendments to the Position Limit Procedures, and any action taken to amend the Position Limit Procedures to ensure compliance with all applicable position limits. Each swap dealer and major swap participant shall retain a copy of this report.

(h) On an annual basis, each swap dealer and major swap participant shall audit its Position Limit Procedures as part of the audit of its Risk Management Program required by Commission regulations.

(i) All records required to be maintained pursuant to these regulations shall be maintained in accordance with 17 CFR 1.31 and shall be made available promptly upon request to representatives of the Commission and to representatives of applicable prudential regulators.

§ 23.602 Diligent supervision.

(a) *Supervision.* Each swap dealer and major swap participant shall establish and maintain a system to supervise, and shall diligently supervise, all activities relating to its business performed by its partners, members, officers, employees, and agents (or persons occupying a similar status or performing a similar function). Such system shall be reasonably designed to achieve compliance with the requirements of the Commodity Exchange Act and Commission regulations.

(b) *Supervisory System.* Such supervisory system shall provide, at a minimum, for the following:

(1) The designation, where applicable, of a person with authority to carry out the supervisory responsibilities of the swap dealer or major swap participant for all activities relating to its business as a swap dealer or major swap participant.

(2) The use of reasonable efforts to determine that all supervisors are

qualified and meet such standards of training, experience, competence, and such other qualification standards as the Commission finds necessary or appropriate.

§ 23.603 Business continuity and disaster recovery.

(a) *Business continuity and disaster recovery plan required.* Each swap dealer and major swap participant shall establish and maintain a written business continuity and disaster recovery plan that outlines the procedures to be followed in the event of an emergency or other disruption of its normal business activities. The business continuity and disaster recovery plan shall be designed to enable the swap dealer or major swap participant to continue or to resume any operations by the next business day with minimal disturbance to its counterparties and the market, and to recover all documentation and data required to be maintained by applicable law and regulation.

(b) *Essential components.* The business continuity and disaster recovery plan of a swap dealer or major swap participant shall include the following components:

(1) Identification of the documents, data, facilities, infrastructure, personnel and competencies essential to the continued operations of the swap dealer or major swap participant and to fulfill the obligations of the swap dealer or major swap participant.

(2) Identification of the supervisory personnel responsible for implementing each aspect of the business continuity and disaster recovery plan and the emergency contacts required to be provided pursuant to this regulation.

(3) A plan to communicate with the following persons in the event of an emergency or other disruption, to the extent applicable to the operations of the swap dealer or major swap participant: Employees; counterparties; swap data repositories; execution facilities; trading facilities; clearing facilities; regulatory authorities; data, communications and infrastructure providers and other vendors; disaster recovery specialists and other persons essential to the recovery of documentation and data, the resumption of operations, and compliance with the Commodity Exchange Act and Commission regulations.

(4) Procedures for, and the maintenance of, back-up facilities, systems, infrastructure, personnel and other resources to achieve the timely recovery of data and documentation and to resume operations as soon as

reasonably possible and generally within the next business day.

(5) Maintenance of back-up facilities, systems, infrastructure and personnel in one or more areas that are geographically separate from the swap dealer's or major swap participant's primary facilities, systems, infrastructure and personnel (which may include contractual arrangements for the use of facilities, systems and infrastructure provided by third parties).

(6) Back-up or copying, with sufficient frequency, of documents and data essential to the operations of the swap dealer or major swap participant or to fulfill the regulatory obligations of the swap dealer or major swap participant and storing the information off-site in either hard-copy or electronic format.

(7) Identification of potential business interruptions encountered by third parties that are necessary to the continued operations of the swap dealer or major swap participant and a plan to minimize the impact of such disruptions.

(c) *Distribution to employees.* Each swap dealer and major swap participant shall distribute a copy of its business continuity and disaster recovery plan to relevant employees and promptly provide any significant revision thereto. Each swap dealer and major swap participant shall maintain copies of the business continuity and disaster recovery plan at one or more accessible off-site locations. Each swap dealer and major swap participant shall train relevant employees on applicable components of the business continuity and disaster recovery plan.

(d) *Commission notification.* Each swap dealer and major swap participant shall promptly notify the Commission of any emergency or other disruption that may affect the ability of the swap dealer or major swap participant to fulfill its regulatory obligations or would have a significant adverse effect on the swap dealer or major swap participant, its counterparties, or the market.

(e) *Emergency contacts.* Each swap dealer and major swap participant shall provide to the Commission the name and contact information of two employees who the Commission can contact in the event of an emergency or other disruption. The individuals identified shall be authorized to make key decisions on behalf of the swap dealer or major swap participant and have knowledge of the firm's business continuity and disaster recovery plan. The swap dealer or major swap participant shall provide the Commission with any updates to this information promptly.

(f) *Review and modification.* A member of the senior management of each swap dealer and major swap participant shall review the business continuity and disaster recovery plan annually or upon any material change to the business. Any deficiencies found or corrective action taken shall be documented.

(g) *Testing.* Each business continuity and disaster recovery plan shall be tested annually by qualified, independent internal audit personnel or a qualified third party audit service. The date the testing was performed shall be documented, together with the nature and scope of the testing, any deficiencies found, any corrective action taken, and the date that corrective action was taken.

(h) *Business continuity and disaster recovery plans required by other regulatory authorities.* A swap dealer or major swap participant shall comply with the requirements of this regulation in addition to any business continuity and disaster recovery requirements that are imposed upon the swap dealer or major swap participant by its prudential regulator or any other regulatory or self-regulatory authority.

(i) *Recordkeeping.* The business continuity and disaster recovery plan of the swap dealer and major swap participant and all other records required to be maintained pursuant to this section shall be maintained in accordance with Commission Regulation § 1.31 and shall be made available promptly upon request to representatives of the Commission and to representatives of applicable prudential regulators.

§ 23.604 [Reserved]

§ 23.605 [Reserved]

§ 23.606 General information: Availability for disclosure and inspection.

(a) *Disclosure of information.* (1) Each swap dealer and major swap participant shall make available for disclosure to and inspection by the Commission and its prudential regulator, as applicable, all information required by, or related to, the Commodity Exchange Act and Commission regulations, including:

- (i) The terms and condition of its swaps;
- (ii) Its swaps trading operations, mechanisms, and practices;
- (iii) Financial integrity and risk management protections relating to swaps; and
- (iv) Any other information relevant to its trading in swaps.

(2) Such information shall be made available promptly, upon request, to Commission staff and the staff of the

applicable prudential regulator, at such frequency and in such manner as is set forth in the Commodity Exchange Act, Commission regulations, or the regulations of the applicable prudential regulator.

(b) *Ability to provide information.*
(1) Each swap dealer and major swap participant shall establish and maintain reliable internal data capture, processing, storage, and other operational systems sufficient to capture, process, record, store, and produce all information necessary to satisfy its duties under the Commodity Exchange Act and Commission regulations. Such systems shall be designed to produce the information within the time frames set forth in the Commodity Exchange Act and Commission regulations or upon request, as applicable.

(2) Each swap dealer and major swap participant shall establish, implement, maintain, and enforce written procedures for the capture, processing, recording, storage, and production of all information necessary to satisfy its duties under the Commodity Exchange Act and Commission regulations.

(c) *Record retention.* All records or reports that a swap dealer or major swap participant is required to maintain pursuant to this regulation shall be maintained in accordance with 17 CFR 1.31 and shall be made available promptly upon request to representatives of the Commission and to representatives of applicable prudential regulators.

§ 23.607 Antitrust considerations.

(a) No swap dealer or major swap participant shall adopt any process or take any action that results in any unreasonable restraint of trade, or impose any material anticompetitive burden on trading or clearing, unless necessary or appropriate to achieve the purposes of the Commodity Exchange Act.

(b) Consistent with its obligations under paragraph (a) of this section, each swap dealer and major swap participant shall adopt policies and procedures to prevent actions that result in unreasonable restraint of trade, or impose any material anticompetitive burden on trading or clearing.

Issued in Washington, DC, on November 10, 2010, by the Commission.

David A. Stawick,
Secretary of the Commission.

Statement of Chairman Gary Gensler

Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants

I support the proposed business conduct standards rulemaking that establishes risk management policies for swap dealers and major swap participants. One of the primary goals of the Dodd-Frank Act was to bring swap dealers and major swap participants under comprehensive regulation to reduce risk to the financial system and to the economy as a whole. The proposed rules are consistent with the Congressional requirement that swap dealers and major swap participants: (1) Monitor trading to prevent violations of position limits; (2) establish risk management procedures for managing their day-to-day business; (3) disclose to the Commission and to applicable prudential regulators general information relating to trading practices and financial integrity of swaps; (4) establish and enforce internal systems and procedures to obtain information needed to perform all of the duties prescribed; (5) implement conflicts of interest systems and procedures; and (6) refrain from unreasonably restraining trade or imposing an anticompetitive burden on trading or clearing.

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DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[Docket No. USCG-2010-0997]

RIN 1625-AA00

Safety Zones: Fireworks Displays in the Captain of the Port Columbia River Zone

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes to amend the enforcement period for the safety zone established for the Oregon Symphony Concert Fireworks Display in Portland, Oregon. The amendment is necessary because in recent years the actual date of the event has differed from that listed in the enforcement period of the regulation.

DATES: Comments and related material must be received by the Coast Guard on or before February 22, 2011. Requests for public meetings must be received by the Coast Guard on or before January 7, 2011. The Coast Guard anticipates that