

U.S. Derivatives Recordkeeping Regulation for Security-Based Swaps

A Practical Guidance® Practice Note by
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This practice note discusses the recordkeeping and reporting requirements as applied to security-based swap dealers, major security-based swap participants, and broker-dealers. The framework contemplated under the Dodd-Frank Act for U.S. derivative reporting is explored in detail, to aid in the development of compliance processes for security-based swap activity.

This practice note covers:

- Overview
- Recordkeeping and Preservation Rules
- Reporting Rules
- Notification
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- Cross-Border Application
- Conclusion

For related information on the U.S. regulatory framework for derivatives under the Dodd-Frank Act, refer to [Dodd-Frank Wall Street Reform and Consumer Protection Act Key Provisions](#), [U.S. Financial Regulatory Structure following the Dodd-Frank Act](#), and [Swaps and Security-Based Swaps under Title VII of the Dodd-Frank Act: U.S. Regulation](#). For a review of the U.S. derivatives market joint regulatory regime and its application to security-based swaps, see

[U.S. Derivatives: SEC/CFTC Joint Rulemaking Authority, Regulatory Oversight and Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants.](#)

Overview

On September 19, 2019, the Securities and Exchange Commission (the SEC) adopted a final set of rules and related amendments, Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers, 84 Fed. Reg. 68550 (the Recordkeeping Rules), establishing a recordkeeping, reporting, and notification regime with respect to security-based swaps. The Recordkeeping Rules apply to security-based swap dealers (SBSDs), major security-based swap participants (MSBSPs), and broker-dealers and became effective on February 14, 2020. The initial compliance date was October 6, 2021.

Pursuant to its rulemaking authority under the Securities Exchange Act of 1934 (the Act), the SEC first proposed a set of recordkeeping, reporting, and notification rules applicable to security-based swaps, Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, 79 Fed. Reg. 25194 (May 2, 2014), (the Proposed Rules). The Proposed Rules included (1) amendments to then-existing rules applicable to broker-dealers to incorporate security-based swaps into such rules and (2) proposed new rules applicable to SBSBs and MSBSPs that are not broker-dealers, modeled principally on the broker-dealer rules. The Recordkeeping Rules are based largely on the Proposed Rules, taking into account certain comments that the SEC received regarding the Proposed Rules.

In particular, the Recordkeeping Rules amended the following existing rules applicable to broker-dealers in order to address their security-based swap activities: 17 C.F.R. § 240.17a-3 (Rule 17a-3), 17 C.F.R. § 240.17a-4 (Rule 17a-4), 17 C.F.R. § 240.17a-5 (Rule 17a-5), and 17 C.F.R. § 240.17a-11 (Rule 17a-11). The Recordkeeping Rules adopted the following new rules applicable to SBSBs and MSBSPs: 17 C.F.R. § 240.18a-5 (Rule 18a-5), 17 C.F.R. § 240.18a-6 (Rule 18a-6), 17 C.F.R. § 240.18a-7 (Rule 18a-7), 17 C.F.R. § 240.18a-8 (Rule 18a-8), and 17 C.F.R. § 240.18a-9 (Rule 18a-9). In addition, Part II of the SEC's Financial and Operational Combined Uniform Single Report (the FOCUS Report) was amended and a new Part IIC was added thereto, in order to accommodate various reporting requirements. Rules relating to cross-border application (17 C.F.R. § 240.3a71-6) and alternative compliance (17 C.F.R. § 240.18a-10 (Rule 18a-10)) were also amended by the Recordkeeping Rules. Technical and conforming changes were made to a number of related rules. According to the SEC, the Recordkeeping Rules are expected to improve the regulatory oversight and documentation of the security-based swap activities of broker-dealers, SBSBs, and MSBSPs, as well as alert the agency to potential risk events of an institution.

The Recordkeeping Rules include the following key points:

- Record-making requirements for SBSBs and MSBSPs and amended record-making requirements for broker-dealers to address their security-based swap activity
- Record preservation requirements for SBSBs and MSBSPs and amended record preservation requirements for broker-dealers to address their security-based swap activity
- Periodic reporting and annual audit requirements for SBSBs and MSBSPs and amended reporting and audit requirements for broker-dealers to address their security-based swap activity
- Early warning notification requirements for SBSBs and MSBSPs
- Security count requirements for SBSBs that are not registered as broker-dealers and do not have a prudential regulator
- Mechanism to request substituted cross-border compliance with respect to recordkeeping and reporting requirements for SBSBs and MSBSPs –and–
- Mechanism for alternative compliance for certain SBSBs to comply with CFTC requirements in lieu of SEC requirements

Recordkeeping and Preservation Rules

Under the Recordkeeping Rules, broker-dealers (including SBSBs and MSBSPs which are broker-dealers) are subject to the requirements of revised Rules 17a-3 and 17a-4. Stand-alone and bank SBSBs and MSBSPs are subject to the requirements of the new Rules 18a-5 and 18a-6. The rules applicable to the different entities are similar, but not entirely parallel, as the SEC has indicated that some activities are not expected or permitted to be conducted by stand-alone and bank SBSBs and MSBSPs. In addition, the SEC noted that the rules applicable to bank SBSBs and MSBSPs are tailored to their security-based swap activities as an SBSB or MSBSP, 84 Fed. Reg. 68550.

Recordkeeping

Under Rule 17a-3, broker-dealers are required to make and keep current a wide range of books and records relating to their business, including a number of blotters, daily trading records, ledger accounts, memoranda, and other records relating to security-based swaps. The new Rule 18a-5 includes two similar sets of recordkeeping requirements applicable to different sets of SBSB and MSBSP entities. Rule 18a-5(a) includes requirements for stand-alone SBSBs and MSBSPs, while Rule 18a-5(b) includes the requirements for SBSBs and MSBSPs for which there is a prudential regulator. As noted above, the requirements for non-broker-dealers are slightly narrower than the broker-dealer requirements.

Among other records relating to security-based swaps under both Rule 17a-3 and Rule 18a-5, broker-dealers, SBSBs, and MSBSPs are required to keep:

- Records of each security-based swap transaction which include the following data elements: the type of security-based swap, the reference security, index, or obligor, the date and time of execution, the effective date, the scheduled termination date, the notional amount(s) and the currenc(ies) in which the notional amount(s) is expressed, the unique transaction identifier, and the counterparty's unique identification code
- A securities record or ledger reflecting, for each security-based swap, whether it is a "bought" or "sold" position in the security-based swap, whether the security-based swap is cleared or not cleared, and if cleared, identification of the clearing agency where the security-based swap is cleared

- With respect to each security-based swap, copies of the security-based swap trade acknowledgment and verification made in compliance with Section 240.15Fi-2
- For each security-based swap account, a record of the unique identification code of such counterparty, the name and address of such counterparty, and a record of the authorization of each person the counterparty has granted authority to transact business in the security-based swap account
- Information regarding “associated persons”:
 - As it relates to SBSBs and MSBSBs, the recordkeeping requirement in the rules referred to in this section is specific to “associated persons” who effect or are involved in effecting security-based swaps on the firm’s behalf
 - The recordkeeping requirement as mentioned above precludes situations where an “associated person” is prohibited under the laws of a non-U.S. jurisdiction from receiving, creating, or maintaining a record of the information required under the rule
- Pursuant to separate rulemaking by the SEC (Cross-Border Application of Certain Security-Based Swap Requirements, 85 Fed. Reg. 6270 (February 4, 2020)), SBSBs and MSBSBs are not required to report certain information relating to associated persons who are not U.S. persons (as that term is defined in Section 240.3a71-3(a)(4)(i)(A)) (This exception is meant to address situations in which an SBSB or MSBSB may be prohibited by applicable non-U.S. law from receiving, creating, or maintaining records with respect to certain of the information that would otherwise need to be recorded pursuant to the recordkeeping requirements; a record of each security-based swap transaction that is not verified under Section 240.15Fi-2 within five business days of execution that includes, at a minimum, the unique transaction identifier and the counterparty’s unique identification code.)
- Records documenting compliance with the business conduct standards –and–
- Records of security-based swap portfolio reconciliation

The SEC, in the adopting release, clarified that, for certain of these elements, registrants may record the same information provided pursuant to Rule 901 of Regulation SBSR to satisfy the related requirements of Rules 17a-3 and 18a-5.

As noted above, Rules 17a-3 and 18a-5 include limited alternative compliance mechanisms for certain entities. Under Rules 17a-3(b) and 18a-5(c), entities which are registered as both (1) SBSBs or MSBSBs and (2) swap

dealers or major swap participants may, subject to other specified conditions, comply with certain of the recordkeeping requirements of the Commodity Exchange Act (CEA) applicable to swap dealers and major swap participants in lieu of complying with certain SEC recordkeeping requirements, solely with respect to required information regarding security-based swap transactions and positions.

Record Maintenance and Preservation

Rule 17a-4 requires broker-dealers to maintain and preserve certain types of records relating to security-based swaps and other activities for prescribed periods of time and in specified formats. The new Rule 18a-6 includes similar maintenance and preservation requirements applicable to stand-alone SBSBs and MSBSBs and to SBSBs and MSBSBs for which there is a prudential regulator, with the requirements for the latter being more limited in scope.

Rules 17a-4 and 18a-6 provide different maintenance and preservation requirements for different types of data and records. Under Rule 17a-4(a) and Rule 18a-6(a)(1) and (2), certain records must be preserved for a period of not less than six years, the first two years in an easily accessible place. Rule 17a-4(b) and Rule 18a-6(b)(1) and (2) require certain records be preserved for a period of not less than three years, the first two in an easily accessible place. The remainder of Rules 17a-4 and 18a-6 include various time periods and accessibility requirements for other types of records.

Specific requirements for the use of electronic storage are set forth in Rules 17a-4(f) and 18a-6(e). In one notable distinction, broker-dealers are required to use electronic media that is “non-rewriteable and non-erasable” (also known as a write-once, read many (WORM) format). The SEC, in the adopting release, noted that stand-alone or bank SBSBs or MSBSBs “may have existing electronic storage systems that do not meet the WORM requirement and therefore could incur substantial costs in building a recordkeeping system that meets this requirement.”

Under Rules 17a-4(j) and 18a-6(g), all entities subject to the rules must furnish promptly to a representative of the SEC legible, true, complete, and current copies of all records required to be preserved under the respective rules.

Reporting Rules

Under Rule 17a-5, broker-dealers are required to file (1) periodic unaudited reports about their financial and operational condition pursuant to the FOCUS Report and (2) annual financial statements and certain related

reports, including reports prepared by independent public accountants in accordance with Public Company Accounting Oversight Board (PCAOB) standards. Under the Recordkeeping Rules, the requirements under Rule 17a-5 have been expanded to cover broker-dealers' security-based swap activities. The new Rule 18a-7 includes similar sets of reporting requirements applicable to bank and stand-alone SBSB and MSBSP entities, creating a reporting regime for such entities. Broker-dealers which are also SBSBs or MSBSPs are generally subject to Rule 17a-5, but it should be noted that the Recordkeeping Rules provide different treatment for OTC derivatives dealers which are also SBSBs, subjecting those entities instead to the requirement of Rule 18a-7.

The SEC, in the Proposed Rules, had considered adding a new Form SBS to the FOCUS Report, to be filed by all SBSBs and MSBSPs. However, in adopting the Recordkeeping Rules, the SEC determined to consolidate Form SBS and the existing FOCUS Report Parts II, IIB, and II CSE into a single new form, FOCUS Report Part II, to be filed by covered entities other than bank SBSBs and MSBSPs. The SEC also created a new FOCUS Report Part IIC to be filed only by bank SBSBs and MSBSPs. As noted in the adopting release, the decision to create a separate form for bank SBSBs and MSBSPs was based on the more limited information required to be reported by those entities. Broker-dealers that previously filed Part II CSE and OTC derivatives dealers that previously filed Part IIB will instead be required to file FOCUS Report Part II, as amended, since FOCUS Report Parts II CSE and IIB will be discontinued. The information they will be required to enter into the revised FOCUS Report Part II is substantively the same as that required for FOCUS Report Parts II CSE and IIB. For other broker-dealers that were previously required to file FOCUS Report Part II, they will continue to file FOCUS Report Part II and the required information is substantively the same.

The Recordkeeping Rules include changes to FOCUS Report Part II and the corresponding instructions intended to update the form, reflect the required filers, and account for these firms' derivatives activity, all intended to reflect the revised reporting requirements noted above.

Bank SBSBs and MSBSPs also have different timing requirements with respect to Part IIC, having less frequent reporting and a longer period to make required filings than stand-alone SBSBs and MSBSPs required to file Part II. Rule 18a-7(a)(2) requires bank SBSBs and MSBSPs to file Part IIC within 30 calendar days after the end of each calendar quarter, while Rule 18a-7(a)(1) requires stand-alone SBSBs and MSBSPs to file Part II within 17 business days after the

end of each month. The quarterly reporting is intended to align with banks' existing obligations to file quarterly "call reports" with their respective prudential regulators.

The SEC had initially proposed to require bank SBSBs and MSBSPs to file Form SBS 17 business days after the end of the quarter. In response to comments received and to promote harmonization with prudential regulators' requirements, the SEC adopted the 30 calendar-day requirement noted in the discussion above. Since the originally proposed 17 business-day requirement would have provided bank SBSBs and MSBSPs with approximately 24 calendar days (based on an assumption of no public holidays), the 30 calendar-day requirement provides administrative relief to bank SBSBs and MSBSPs by giving them six additional calendar days to file the FOCUS Report Part IIC.

Rule 18a-7(a)(3) makes an additional distinction with respect to SBSBs that use internal models to compute net capital, requiring such SBSBs to file additional reports with the SEC on a monthly or quarterly basis, which aligns with similar requirements for broker-dealers that compute net capital pursuant to 17 C.F.R. § 240.15c3-1e.

Rule 17a-5(c) requires that broker-dealers send to their customers (1) on an annual basis, audited statements that include information about net capital and material weaknesses in internal compliance control and (2) certain unaudited statements six months after the audited statements. Under the new Rule 18a-7(b), stand-alone SBSBs and MSBSPs are required to make similar information publicly available on their websites.

The remainder of Rule 18a-7 includes additional annual reports and specifies the nature and form of such reports as well as qualifications for public accountants. These rules are similar to many of the requirements imposed on broker-dealers under the remaining provisions of Rule 17a-5.

Notably, unlike Rule 17a-5, Rule 18a-7 does not require the covered entities to engage an accountant that is registered with the PCAOB. In fact, the Commission notes that stand-alone SBSBs and MSBSPs are not currently subject to a statutory requirement that their financial statements be certified by a PCAOB-registered accountant, nor are audits of such entities subject to the PCAOB's examination and enforcement authority. Under the Reporting Rules, stand-alone SBSBs and MSBSPs, as well as SBSBs that are also registered as OTC derivatives dealers, have the option to engage an independent public accountant that is not registered with the PCAOB, and such independent public accountant may use either GAAS in the United States or PCAOB standards.

Notification

Under Rule 17a-11, broker-dealers are required to notify the SEC and other regulators about certain events relating to their financial or operational condition. Under the Recordkeeping Rules, the requirements under Rule 17a-11 have been expanded to cover broker-dealers' security-based swap activities. The new Rule 18a-8 includes similar sets of reporting requirements applicable to bank and stand-alone SBSB and MSBSP entities, creating similar notice requirements for such entities. Broker-dealers which are also SBSBs or MSBSPs are generally subject to Rule 17a-11, but it should be noted that the Recordkeeping Rules provide different treatment for OTC derivatives dealers which are also SBSBs, subjecting those entities instead to the requirement of Rule 18a-8.

Events requiring notice pursuant to both Rule 17a-11 and Rule 18a-8 include, without limitation, the following:

- Failure to meet minimum capital requirements (other than bank SBSBs and MSBSPs)
- Early warning of potential capital or model problems (other than bank SBSBs and MSBSPs)
- Adjustment of reported capital category (applicable only to bank SBSBs)
- Failure to make and keep current books and records
- Material weakness (applicable to broker-dealers and stand-alone SBSBs)
- Failure to make a required reserve deposit (other than MSBSPs)

Quarterly Securities Count

Rule 17a-13 requires certain broker-dealers to take the following actions at least once per calendar quarter:

- Physically examine and count all securities held
- Account for all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements, or otherwise subject to their control or direction but not in their physical possession
- Verify all securities in transfer, in transit, pledge, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements, or otherwise subject to their control or direction but not in their physical possession, where such securities have been in said status for longer than 30 days
- Compare the results of the count and verification with the records –and–

- Record on their books and records all unresolved differences no later than seven business days after the date of each required quarterly security examination, count, and verification

These requirements will now cover broker-dealers' security-based swaps as well. The new Rule 18a-9 imposes similar requirements on stand-alone SBSBs. The SEC, in adopting the Recordkeeping Rules, noted that these requirements would not apply to MSBSPs in part due to a diminished concern about customer protection with respect to the activities of MSBSPs.

Alternative Compliance Mechanism

Rule 18a-10 provides an alternative compliance mechanism, allowing certain SBSBs to comply with the capital, margin, segregation, recordkeeping, and reporting requirements of the CEA and Chapter I of Title 17 of the Code of Federal Regulations in lieu of complying with 17 C.F.R. § 240.18a-1 and 17 C.F.R. § 240.18a-3 through 17 C.F.R. § 240.18a-9, subject to specified conditions.

For an SBSB to qualify for the alternative compliance mechanism described above, the following conditions must be satisfied:

- The SBSB is registered as such pursuant to Section 15F(b) of the Act and the rules thereunder.
- The SBSB is registered as a swap dealer pursuant to Section 4s of the CEA and the rules thereunder.
- The SBSB is not registered as a broker or dealer pursuant to Section 15 of the Act or the rules thereunder.
- The SBSB meets the conditions to be exempt from the segregation requirements of 17 C.F.R. § 240.18a-4. – and –
- As of the most recently ended quarter of the fiscal year of the SBSB, the aggregate gross notional amount of the outstanding security-based swap positions of the SBSB did not exceed the lesser of the maximum fixed-dollar amount specified in paragraph (f) of Rule 18a-10 (\$250 billion until the three-year anniversary of the compliance date and then \$50 billion unless the SEC issues an order to maintain the \$250 billion or reduce it to an amount between \$50 billion and \$250 billion) or 10% of the combined aggregate gross notional amount of the open security-based swap and swap positions of the SBSB.

For purposes of clarification, Rule 18a-10(1) specifies that an SBSB taking advantage of the alternate compliance must “comply with capital, margin, segregation, recordkeeping, and reporting requirements of the [CEA] and chapter I of [Title 17 of the Code of Federal Regulations] applicable to swap dealers and treat security-based swaps or collateral related to security-based swaps as swaps or collateral related to swaps, as applicable, pursuant to those requirements to the extent the requirements do not specifically address security-based swaps or collateral related to security-based swaps.”

Rule 18a10 further requires that an SBSB must provide certain notifications to its counterparties regarding its alternate compliance and must notify the SEC of its intent to operate pursuant to the alternate compliance mechanism.

Cross-Border Application

Pursuant to 17 C.F.R. § 240.3a71-6 (Rule 3a71-6), the SEC may, “conditionally or unconditionally, by order, make a determination with respect to a foreign financial regulatory system that compliance with specified requirements under such foreign financial regulatory system by a registered [SBSB] and/or by a registered [MSBSP]” may satisfy specific regulatory requirements applicable to such entity. In accordance with the Rule, such a determination by the SEC would be made, upon request, based on a determination that the requirements of such foreign financial regulatory system are comparable to otherwise applicable requirements, taking certain factors into account.

The Recordkeeping Rules expanded the scope of Rule 3a71-6 to provide a mechanism for substituted compliance with the recordkeeping and reporting requirements of Section 15F of the Act and Rules 18a-5 through 18a-9. The SEC included, as a specific additional point for consideration in any determination of comparability with respect to these requirements, “whether the foreign financial regulatory system’s required records and reports, the timeframes for recording or reporting information, the accounting standards governing the records and reports, and the required format of the records and reports are comparable to applicable provisions arising under the Act and its rules and regulations and would permit the [SEC] to examine and inspect regulated firms’ compliance with the applicable securities laws.”

Conclusion

The Recordkeeping Rules impose a wide range of security-based swap recordkeeping, reporting, notification, and record preservation requirements on broker-dealers as well as SBSBs and MSBSPs. The Recordkeeping Rules became effective on February 14, 2020, with an initial compliance date of October 6, 2021.

On November 18, 2021, the SEC proposed amendments to the electronic recordkeeping requirements applicable to (1) broker-dealers under Rule 17a-4 and (2) SBSBs and MSBSPs under Rule 18a-6. The comment period for such proposed amendments closed on January 3, 2022.

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Douglas Youngman is a New York financial services attorney who focuses his practice in the field of derivatives, complex financial transactions and structured products.

Mr. Youngman has more than 22 years of experience in financial services and related transactions. He advises clients on the negotiation and execution of a wide range of derivatives, including interest rate swaps, total return swaps, credit default swaps, caps and options, as well as guaranteed investment contracts, forward purchase agreements, repurchase agreements and other reinvestment products. He also counsels clients on structured finance, liquidity (letter of credit, standby bond purchase, revolving credit), bank lending and direct purchase transactions in the municipal and tax-exempt healthcare and higher education markets.

Mr. Youngman has extensive experience representing lenders, creditors and service providers in connection with municipal bankruptcy, under both the U.S. Bankruptcy Code and Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), and in respect of distressed municipalities.

In addition, Mr. Youngman advises clients regarding issues arising from the discontinuation of Libor in both the derivatives and cash/lending markets, providing guidance related to the Secured Overnight Financing Rate (SOFR) and other replacement rates, and the implementation of fallbacks recommended by the Federal Reserve’s Alternative Reference Rates Committee (ARRC) and the International Swaps and Derivatives Association (ISDA).

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