



July 29, 2019

**VIA ONLINE SUBMISSION**

Christopher Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

**RE: Certain Swap Data Repository and Data Reporting Requirements, RIN 3038-AE32**

Dear Mr. Kirkpatrick:

By this letter, the Natural Gas Supply Association (“NGSA”) respectfully submits comments regarding the U.S. Commodity Futures Trading Commission’s (the “CFTC’s”) Notice of Proposed Rules Making, Certain Swap Data Repository and Data Reporting Requirements, 84 Fed. Reg. 21044 (May 13, 2019) (the proposed rule referred to herein, respectively, as the “Proposed Rule” and the “Proposing Release”). NGSA is particularly concerned with the proposed rules regarding verification of swap data accuracy and errors and omissions reporting and is submitting these comments on the original comment closing date in order to provide CFTC staff and other market participants time to consider the serious and negative industry impacts of these sections of the Proposed Rule. Additionally, given the title of the Proposed Rule the end-user community is likely unaware of the potential negative impacts of the verification loop. Therefore, the NGSA appreciates the CFTC extending the comment deadline on this Proposed Rule in order to give other market participants additional time to consider the impacts of these regulatory changes on the market as a whole, not just on swap data repositories (“SDRs”).

While the CFTC is hopeful that the Proposed Rule, if adopted, would significantly improve the administration of SDRs, NGS is concerned that absent a few key changes, the Proposed Rule will hamper non-bank swap dealer (“Non-Bank SD”) and non-swap dealer/major swap participant reporting counterparty (“Non-SD/MSP Reporting Counterparty”) participation in the market through the introduction of new regulatory obligations. **Non-Bank SD and Non-SD/MSP Reporting Counterparty participation in the market provides liquidity and counterparty diversification that is vital to affordable hedging for end users.** As noted in CFTC Commissioner Dan M. Berkovitz’s recent June 27, 2019 statement, “Swap trading is highly concentrated. The five largest swap dealing banking institutions were party to 70% of all swaps and 80% of the total notional amount traded. Expanding and diversifying the sources of liquidity should improve price discovery and the safety and resiliency of the swap markets.”<sup>1</sup>

The verification process under the Proposed Rule carries certain risks to liquidity in the form of 1) additional investment in technological systems to review and reconcile open swaps positions,<sup>2</sup> 2) additional investment in maintenance of records of all data elements,<sup>3</sup> and 3) additional staff and training required for both Non-Bank SDs and Non-SD/MSP Reporting Counterparties to meet time deadlines for verification of 48 hours or 96 hours of the SDR providing the open swaps report respectively and errors and omissions reporting within 3 business days of discovery.<sup>4</sup> Additionally, reporting parties will necessarily need to implement further verification processes with their non-reporting counterparties, creating further cost and obligation for both participants not addressed by the Proposing Release. The practical effect of developing the systems to

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<sup>1</sup> See Statement of Commissioner Dan M. Berkovitz in Support of the Staff No Action Letter Regarding Floor Traders, June 27, 2019 available at: <https://cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement062719#> Just as these comments were targeted at increasing liquidity on electronic platforms by granting relief to proprietary floor traders thereby increasing the number of counterparties available, so too should the CFTC be concerned with action which discourages existing Non-SD/MSP Reporting Counterparties from transacting with each other or creating barriers to entry for new smaller market participants through the verification and errors and omission process.

<sup>2</sup> See Proposing Release at 21092. Given the additional investment necessary in systems it is likely that non-swap dealer/major swap participant counterparties will choose not to be reporting counterparties to avoid the investment, limiting the non-swap dealer/major swap participant to non-swap dealer/major swap participant transactions in the market. Further, for multiple SDRs, this will require multiple development as the form of verification will differ from SDR to SDR.

<sup>3</sup> See Proposing Release at 21092 and footnote 257 which correctly references swap dealer and major swap participant current recordkeeping requirements under 17 CFR 45.2. Consideration must be given as to whether the data required to be kept under the verification and errors and omissions process by Non-SD/MSP Reporting Counterparties represents an expansion of current recordkeeping requirements existing for these entities under 17 CFR 45.2(b) and any expansion should be discouraged in order to avoid additional expenses to compliance which would limit liquidity.

<sup>4</sup> See Proposing Release at 21092. While swap dealers and major swap participants are likely to have cross-trained teams, occasional reporting counterparties are unlikely to do so and therefore will need to invest in additional training and in some cases head count to improve the redundancies necessary to manage the proposed time frames.

comply with the proposed verification loop is a barrier to entry for new market participants that is likely to exacerbate the liquidity and concentration issues observed by Commissioner Berkovitz.

NGSA understands obtaining complete and accurate swap data is one of the goals of the Proposed Rule. The verification rule implementation for financial institution swap dealers and major swap participants would capture at least 80% of the notional value of the current market (given that the above quoted amount refers only to the five largest swap dealing banking institutions). NGSA does not have a view regarding the need for or appropriateness of a “verification loop” for financial entity transactions in swaps. However, the market data highlights the reality that imposing such a requirement on non-bank SDs and Non-SDs/MSPs Reporting Counterparties is of limited utility given the make-up of the swaps market. Therefore, the burden and expense of implementing these requirements for Non-Bank SDs and Non-SD/MSPs Reporting Counterparties that do not pose systemic risk is not balanced by the benefit of potentially capturing only an incremental improvement to the accuracy of less than 20% of the outstanding notional value of swap data.<sup>5</sup> This imbalance is exacerbated by the liquidity impact to all market participants that would result from the barrier to entry that the verification rule would place on future market participants. As a further illustrative data point, per CFTC Staff, in January 2019 swap dealers represented 85.3056% of the 60,021 commodity trades with Non-SD/MSP Reporting Counterparties representing only 10,399 of those commodity swaps.<sup>6</sup> In respect to commodity swaps alone, therefore, Non-SD/MSP Reporting Counterparty data would account for less than 15% of the relevant data in respect of the verification process. The cost, required resources and unintended consequences of the proposed verification process as

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<sup>5</sup> See Proposing Release at 21075 - 21076 which estimates the cost to each reporting counterparty for verification systems development to be 100 hours to build test and implement the verification system based on SDR instructions (based on creation of a new system) and 10 hours per year to maintain the verification systems and to make any needed updates to conform to any changes to SDR verification policies and procedures (which would be multiplied therefore if multiple SDRs were utilized). Compliance with data reconciliation is estimated at 2 hours per open swaps report. Therefore, for Non-Bank SDs, weekly compliance is estimated at 16 hours per month and for Non-SD/MSP Reporting Counterparties at a 24 hour annual obligation based on monthly reporting and presuming automation of the verification process (which may not be feasible for small Non-SD/MSP Reporting Counterparties). For Non-SD/MSP Reporting Counterparties as a whole this is estimated to be 38,040 hours for a community representing less than 20% of the outstanding notional value of the market. For errors and omissions reporting the estimated burden hours is 30 hours and does not differentiate between swap dealers, major swap participants, Non-Bank SDs and Non-SD/MSP Reporting Counterparties. This costing requires further consideration as it is likely that Non-SD/MSP Reporting Counterparties will require more hours to draft a remediation plan due to constraints on resources and will need to incur costs for additional outside support, including but not limited to, counsel.

<sup>6</sup> See Proposing Release at 21122.

proposed are simply not worth the potential incremental increase in data accuracy. CFTC Commissioner Stump said it well, is this a “solution in search of a problem?”<sup>7</sup>

With regard to Non-Bank SD and Non-SD/MSP Reporting Counterparties data, NGSAs urges the CFTC to resolve data quality issues existing in this small subset of data by a combination of --

1. limiting the reported information to that which serves the underlying goal of improving the CFTC’s market surveillance capabilities and promoting price transparency, in particular eliminating remaining restrictions on the exclusion of inter-affiliate transaction reporting on Non-Bank SD and Non-SD/MSP Reporting Counterparties,
2. conforming the information required by the SDRs in accordance with the International Organization of Securities Commissions (“IOSCO”),
3. limiting optional fields and fields that do not apply to the relevant swaps (of particular consideration for the NGSAs, commodity swaps), and
4. utilizing existing swap dealer and major swap participant portfolio reconciliation processes for verification of swap data.<sup>8</sup>

Only after taking these steps should the CFTC consider additional, and particularly costly, verification and validation requirements and errors and omissions reporting on Non-Bank SDs and Non-SD/MSP Reporting Counterparties as part of a separate rule-making, which would be subject to public comment.

#### **I. The CFTC Should Not Require Market Participants to Report Inter-Affiliate Swaps to the SDR**

As per the comments previously submitted by the NGSAs on August 21, 2017 in response to the DM Swap Data Reporting Review, the NGSAs urges the CFTC to expressly exclude inter-affiliate swaps that involve Non-Bank SDs or an end-user from SDR reporting requirements and therefore from the verification of swap data accuracy and error and omissions reporting requirements in the Proposed Rule. The NGSAs recognizes that the CFTC’s purpose of protecting the integrity of the market through

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<sup>7</sup> See Proposing Release at 21118.

<sup>8</sup> As noted by Commissioner Dawn D. Stump in the Statement of Concurrence to the Proposed Rule, “swap dealers (SDs) are the RCP [reporting counterparties] and transmit required swap data elements to an SDR for the vast preponderance of swap transactions”. See Proposing Release at 21122. This is borne out by the metric provided by Commissioner Dan M. Berkovitz that the five largest swap dealing banking institutions were party to 70% of all swaps and 80% of the total notional amount traded. See *supra* note 1. Since the five largest swap dealing banking institutions are subject to the portfolio reconciliation process, utilizing this existing process will capture the majority of swap data.

market surveillance and price transparency is served by accurate reporting of competitive swap data. However, since inter-affiliate transactions are used for internal risk management and capital efficiency purposes, not for external market-facing competitive purposes, eliminating the reporting of inter-affiliate swaps by Non-Bank SDs and Non-SD/MSP Reporting Counterparties will limit unnecessary data from the swaps data pool which will minimize errors through increased visibility. Additionally, the inclusion of inter-affiliate swaps would give a misleading, overly-inflated representation of the true size of the swaps market. Currently, the reported data does not represent a completely competitive market because data for inter-affiliate transactions are included unless the inter-affiliate is wholly-owned. In other words, inter-affiliate transaction data is included in reporting when the transactions are between majority, but not-wholly-owned, affiliates. Importantly, Non-SD/MSP Reporting Counterparties should exclude both inter-affiliate transactions with wholly owned affiliates and commonly controlled, not wholly-owned, affiliates from reported swap data.

The importance of excluding inter-affiliate swaps from competitive market data cannot be overstated. Without inter-affiliate transactions, wholly owned or commonly controlled affiliates may “compete” with each other and other market participants to manage their risk and capital requirements in competitive markets. **Inter-affiliate transactions provide capital efficiency by allowing affiliates to internally “net” capital and risk management requirements before turning to the competitive market.** The resulting capital efficiency benefits all market participants. Reporting of inter-affiliate transactions distorts the understanding of the competitive market and provides limited value in achieving the CFTC’s objectives of market transparency and the reduction of systemic risk. The competitive market appears larger than it is because inter-affiliate transactions, which may or may not be arm’s-length, are used for internal allocation of risk and capital. Inter-affiliate transactions, by nature of the fact that they are contained within a corporate group, do not represent systemic market risk or provide competitive market transparency. Thus, reporting of inter-affiliate transactions will produce an inaccurate and misleading picture of the market because it mixes non-competitive data with competitive market data.

The CFTC has repeatedly recognized that inter-affiliate transactions are often not intended to be arm’s-length but instead are intended to manage risk between affiliates and are therefore not concerned with obtaining competitive pricing. In short, data on these swaps does not contribute to price transparency.<sup>9</sup> The CFTC has also recognized that inter-affiliate swaps “do not increase overall system risk or warrant the same

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<sup>9</sup> CFTC Letter No. 14-26 (March 6, 2014) (page 2-page 3) available at: <https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/letter/14-26.pdf> and CFTC Letter No. 17-67 (December 14, 2017) (page 2) available at: <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/17-67.pdf>.

reporting requirements as external swaps (i.e., swaps with unaffiliated entities).<sup>10</sup> Such data, if deemed to be necessary for CFTC purposes in the future, is available to the CFTC upon request to market participants.<sup>11</sup>

NGSA recognizes that changes to the inter-affiliate transaction reporting rule may be the subject of additional rule-making under one of the three anticipated Roadmap rule-makings or otherwise and therefore urges the CFTC to consider this issue holistically when considering the verification process and errors and omissions reporting obligations of Non-Bank SDs and Non-SD/MSP Reporting Counterparties under the Proposed Rule.<sup>12</sup>

**II. The CFTC Should Streamline the SDR Reporting Process Through Harmonization with IOSCO, By Limiting Optional Fields and Fields that Do Not Apply to the Relevant Swap and By Utilizing Existing Portfolio Reconciliation Processes for Verification Purposes.**

Currently the data required to be reported is overbroad and contains optional fields and fields that do not apply to commodity swaps. Additionally, SDRs do not currently have equivalent standards for the data they receive and disclose and the proposed verification process and errors and omissions reporting procedures will introduce a further discretionary layer. Given the sensitivity of swap counterparties to the amount and type of information required and disclosed by SDRs, counterparties will continue to be attracted to SDRs with less stringent requirements and this consideration will now extend to the ease of interacting within a SDR's verification process and errors and omissions reporting procedures including, but not limited to the fields and data required to be verified and corrected. The NGSA therefore urges the CFTC to issue a technical specification which clarifies exactly what must be reported and how and harmonization with the critical data elements from the CPMI-IOSCO works streams to minimize the reporting fields in order to streamline the reporting process (as per the efforts of the SEC in its Final Rule Security-Based Swap Data Repository Registration, Duties and Core Principles 80 CFR 14437 (March 19, 2015) at 14443 available at <https://www.govinfo.gov/content/pkg/FR-2015-03-19/pdf/2015-03127.pdf>).<sup>13</sup>

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<sup>10</sup> CFTC Letter No. 13-09 (April 5, 2013) (page 3) available at:

<https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/13-09.pdf>.

<sup>11</sup> See 17 CFR 45.2.

<sup>12</sup> See Proposing Release at 21045-21046.

<sup>13</sup> See Proposing Release at 21046. Working with IOSCO will further serve the CFTC's goal of taking "into consideration certain pertinent rules adopted by other regulators including the European Securities and Markets



Further in an attempt to align with the SEC's approach to verification currently under consideration, the CFTC should consider utilizing the portfolio reconciliation process currently in place for swap dealers and major swap participants to verify the accuracy of a significant proportion of the relevant swap data thereby utilizing an existing regulatory process for verification and minimizing cost to the market.<sup>14</sup>

**Articulated in NGSAs August 21, 2017 comments, data integrity and liquidity can be improved through a combination of two simple measures: 1) narrow and harmonize the required data reported by market participants to increase integrity of the data pool, and 2) use the *existing* swap dealer portfolio reconciliation process rather than create an additional verification process to reduce expense to the market and focus verification efforts on the largest portion of competitive swap data.** The CFTC already has the tools to increase data integrity and avoid a barrier to entry in the market. It is pointless, costly and risky to reinvent the wheel.

NGSA appreciates the opportunity to provide these comments. Please feel free to contact me should you like to discuss NGSAs comments to the SDR Reporting Rules.

Respectfully Submitted,



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Authority ("ESMA") the U.S. Securities and Exchange Commission ("SEC"). Both ESMA and the SEC have worked with IOSCO on harmonization of data fields for swap data reporting.

<sup>14</sup> See 17 CFR 23.502; 17 CFR 23.431 and the SEC's Notice of Propose Rule-making, Risk Mitigation Techniques for Uncleared Security-Based Swaps 84 CFR 4614 (February 15, 2019) at 4616 available at:

<https://www.govinfo.gov/content/pkg/FR-2019-02-15/pdf/2018-27979.pdf>.