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**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 240**

**[Release No. 34-84511; File No. S7-24-18]**

**RIN 3235-AL10**

**Commission Statement on Certain Provisions of Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Commission statement.

**SUMMARY:** The Commission is issuing a statement regarding certain provisions of its Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants. The statement sets forth the Commission's position, for five years after the compliance date for the security-based swap dealer and major security-based swap participant registration rules, that certain actions with respect to provisions of the Commission's business conduct standards will not provide a basis for a Commission enforcement action.

**DATES:** The Commission's statement is effective [insert date of publication in the Federal Register].

**FOR FURTHER INFORMATION CONTACT:** Lourdes Gonzalez, Assistant Chief Counsel; Joanne Rutkowski, Assistant Chief Counsel; Devin Ryan, Senior Special Counsel; Kelly Shoop, Special Counsel; or Neel Maitra, Special Counsel, at 202-551-5550, in the Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:**

**I. INTRODUCTION**

In 2012 the U.S. Commodity Futures Trading Commission (“CFTC”) adopted business conduct rules for swap dealers and major swap participants (“CFTC’s Business Conduct Rules”).<sup>1</sup> To assist the swaps industry in implementing and complying with the CFTC’s Business Conduct Rules, industry participants developed standardized counterparty relationship documentation that has been in force since 2012, and is currently used by over 22,000 counterparties.<sup>2</sup>

In 2016, pursuant to Section 15F of the Securities Exchange Act of 1934 (“Exchange Act”),<sup>3</sup> the Commission adopted final rules imposing business conduct standards (the “SEC’s Business Conduct Rules”) for security-based swap dealers (“SBS Dealers”) and major security-based swap participants (“Major SBS Participants” and, together with SBS Dealers, “SBS Entities”).<sup>4</sup> As noted in the Commission’s Adopting Release, the Commission endeavored to harmonize its rules with analogous CFTC requirements where possible to create efficiencies for entities that have already established infrastructure for compliance with analogous CFTC requirements.<sup>5</sup> In certain instances, however, the Commission’s requirements, and the associated representations that would be required under standardized counterparty relationship documentation, diverge from those of the analogous CFTC requirements, which are reflected in existing standardized counterparty relationship documentation. Market participants have

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<sup>1</sup> *Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties*, 77 FR 9734 (Feb. 17, 2012).

<sup>2</sup> See International Swaps and Derivatives Association, Inc. (“ISDA”) DF Protocol, List of Adhering Parties, available at <https://www.isda.org/protocol/isda-august-2012-df-protocol/adhering-parties>.

<sup>3</sup> In this document, all references to “Rules” shall mean those under the Exchange Act.

<sup>4</sup> *Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants*, 81 FR 29960 (May 13, 2016) (“Adopting Release”). Although the rules are now effective, the Commission determined not to require compliance with them until entities are required to register as SBS Dealers or Major SBS Participants. See *id.* at 30081.

<sup>5</sup> *Id.* at 29964.

expressed concerns about practical compliance difficulties presented by certain of these differences.<sup>6</sup>

The Commission is mindful of the time and costs that may be associated with a documentation initiative that would be undertaken solely to address the SEC's Business Conduct Rules. Therefore, to minimize potential market disruptions to existing counterparty relationships resulting solely from documentation implementation issues (upon their compliance date when compliance will first be required), for a limited time period, the Commission takes the position that certain actions with respect to provisions of the SEC's Business Conduct Rules will not provide a basis for a Commission enforcement action, as set forth below.<sup>7</sup>

## **II. COMMISSION POSITION**

The Commission's position<sup>8</sup> is expressly limited to the SEC's Business Conduct Rules, 17 CFR 240.15Fh-1 (Rule 15Fh-1) through 240.15Fh-6 (Rule 15Fh-6), set forth below. The Commission emphasizes that its position is limited to the Commission's enforcement discretion with respect to Rules 15Fh-1 through 15Fh-6, and does not modify or change any contractual rights between counterparties to security-based swaps. Further, nothing in the Commission's position excuses compliance with Rule 15Fh-1(b), under which an SBS Entity cannot rely on a representation if it has information that would cause a reasonable person to question the accuracy

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<sup>6</sup> See, e.g., Letter from Securities Industry and Financial Markets Association ("SIFMA") and Institute of International Bankers, June 21, 2018 ("SIFMA June 2018 Letter"); Letter from Church Alliance to Brett Redfean, June 26, 2018 ("Church Alliance June 2018 Letter").

<sup>7</sup> To the extent there are additional differences between the CFTC's Business Conduct Rules and the SEC's Business Conduct Rules that otherwise present documentation implementation difficulties that could result in potential for market disruption, the Commission encourages market participants to provide that information to the Commission.

<sup>8</sup> The Commission's position is an agency statement of general applicability with future effect designed to implement, interpret, or prescribe law or policy.

of the representation.<sup>9</sup> Unless specified below, all terms shall have the definitions set forth in Exchange Act Section 15F(h) and Rules 15Fh-1 through 15Fh-6. Finally, the Commission’s position applies only to the exercise of its enforcement discretion as set forth in subsections A. through D. below, and only until five years after the compliance date for the SBS Entity registration rules.

### **A. Non-ERISA Employee Benefit Plans**

For purposes of the provisions relating to special entities under Rules 15Fh-1 through 15Fh-6, it would not provide a basis for an enforcement action if an SBS Entity considers an employee benefit plan as defined in Rule 15Fh-2(d)(4)<sup>10</sup> not to be a special entity where: (i) the plan has previously represented in writing to the SBS Entity that it is not a special entity for swap purposes under the CFTC’s Business Conduct Rules; (ii) at a reasonably sufficient time<sup>11</sup> prior to entering into a security-based swap with the plan, the SBS Entity notifies the plan in writing that it may opt into special entity status under Rule 15Fh-2(d)(4);<sup>12</sup> and (iii) the plan does not opt into special entity status.

### **B. Written Representations: SBS Dealers Not Acting as Advisors**

Reliance on the representations described below during the five years in which this Commission position is in effect would not provide a basis for an enforcement action:

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<sup>9</sup> See Section II.D., *infra*, for the Commission’s position on written representations that were previously obtained in connection with swaps.

<sup>10</sup> Rule 15Fh-2(d)(4) defines “special entity” to include: “An employee benefit plan as defined in section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) and not otherwise defined as a special entity, unless such employee benefit plan elects not to be a special entity by notifying a security-based swap dealer or major security-based swap participant of its election prior to entering into a security-based swap with the particular security-based swap dealer or major security-based swap participant.”

<sup>11</sup> See, e.g., Adopting Release, 81 FR at 29982 (“[I]t is important that the required disclosures be made at a reasonably sufficient time before the execution of the transaction to allow the counterparty to assess the disclosures.”).

<sup>12</sup> This notification requirement mirrors the approach set forth in CFTC Regulation at 17 CFR 23.401(c)(6).

- An SBS Dealer seeking to establish that it is not acting as an advisor to a special entity within the meaning of Rule 15Fh-2(a) relies on a written representation that a special entity will not rely on recommendations provided by the SBS Dealer<sup>13</sup> instead of having the special entity represent in writing that it acknowledges that the SBS Dealer is not acting as an advisor when the SBS Dealer recommends a security-based swap or a trading strategy that involves the use of a security-based swap to the special entity.<sup>14</sup>
- With respect to a special entity as defined in Rule 15Fh-2(d)(3) (e.g., an employment plan subject to Title I of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) (“ERISA Special Entity”)), an SBS Dealer relies on a representation from the ERISA Special Entity’s fiduciary that such fiduciary is not relying on recommendations provided by the SBS Dealer<sup>15</sup> instead of having the fiduciary represent in writing that it acknowledges that the SBS Dealer is not acting as an advisor when it recommends a security-based swap or a trading strategy that involves the use of a security-based swap to the ERISA Special Entity.<sup>16</sup>
- An SBS Dealer relies on a written representation from the ERISA Special Entity that any recommendation it receives from the SBS Dealer materially affecting a security-based swap transaction will be evaluated by a fiduciary before the

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<sup>13</sup> This written representation mirrors the requirement set forth in CFTC Regulation at 17 CFR 23.440(b)(2)(ii), the analogous provision to Rule 15Fh-2(a)(2)(i)(A).

<sup>14</sup> See Rule 15Fh-2(a)(2)(i)(A).

<sup>15</sup> This written representation mirrors the requirement set forth in CFTC Regulation 23.440(b)(1)(ii), the analogous provision to Rule 15Fh-2(a)(1)(ii).

<sup>16</sup> See Rule 15Fh-2(a)(1)(ii).

transaction occurs, instead of having an ERISA Special Entity represent in writing that any recommendation it receives from the SBS Dealer involving a security-based swap transaction will be evaluated by a fiduciary before the transaction is entered into.<sup>17</sup>

### **C. Safe Harbor for SBS Dealers and Major SBS Participants Acting as Counterparties to Special Entities**

Rule 15Fh-5(b) provides a safe harbor for SBS Entities acting as counterparties to a special entity other than an ERISA Special Entity. As set forth in Rule 15Fh-5(b)(1)(ii)(B), to avail itself of the safe harbor the SBS Entity must among other things, obtain written representations from the representative of the special entity (the “qualified independent representative”) that such representative: (1) meets the independence test as required by Rule 15Fh-5(a)(1)(vii); (2) has the knowledge required under Rule 15Fh-5(a)(1)(i); (3) is not subject to a statutory disqualification under Rule 15Fh-5(a)(1)(ii); (4) undertakes a duty to act in the best interests of the special entity as required by Rule 15Fh-5(a)(1)(iii); and (5) is subject to the requirements regarding political contributions, as applicable, under Rule 15Fh-5(a)(1)(vi).

It would not provide a basis for an enforcement action with respect to relying on the safe harbor in Rule 15Fh-5(b)(1)(ii)(B) if, during the five years in which this Commission position is in effect, instead of obtaining these written representations, an SBS Entity relies on a written representation from the qualified independent representative that the representative has written policies and procedures reasonably designed to ensure that the representative satisfies the requirements for acting as a qualified independent representative.<sup>18</sup> This position is applicable

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<sup>17</sup> See Rule 15Fh-2(a)(1)(iii)(B). This written representation mirrors the requirement set forth in CFTC Regulation 23.440(b), the analogous provision to Rule 15Fh-2(a)(1)(iii)(B).

<sup>18</sup> The Commission notes that this written representation is already required by Rule 15Fh-5(b)(1)(ii)(A), and mirrors the analogous requirement set forth in CFTC Regulation at 17 CFR 23.450(d)(1)(ii)(A).

only to the written representations set forth in Rule 15Fh-5(b)(1)(ii)(B) and is only applicable where the SBS Entity meets all other Commission requirements as set forth in Rule 15Fh-5(b).

#### **D. Reliance on Previously-Obtained Written Representations**

Finally, Rule 15Fh-1(b), as noted above, permits an SBS Entity to rely on written representations from the counterparty or its representative to satisfy its due diligence requirements under Rules 15Fh-1 through 15Fh-6, unless the SBS Entity has information that would cause a reasonable person to question the accuracy of the representation. As the Commission stated when adopting the rule, the question of whether reliance on representations that had been obtained with respect to the CFTC's Business Conduct Rules would satisfy an SBS Entity's obligations under the SEC's Business Conduct Rules will depend on the facts and circumstances of the particular matter.<sup>19</sup> The Commission's position is that, for purposes of Rule 15Fh-1(b), it would not provide a basis for an enforcement action if, during the five years in which this Commission position is in effect, an SBS Dealer relies on representations from a counterparty or representative that were previously provided in relation to swaps if the SBS Dealer is not aware of information that would cause a reasonable person to question the accuracy of the representation if the representation were given in relation to security-based swaps.<sup>20</sup>

By the Commission.

Dated: October 31, 2018.

Brent J. Fields,  
Secretary.

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<sup>19</sup> See Adopting Release, 81 FR at 29976.

<sup>20</sup> This position applies equally to the written representations addressed in Sections II.B. and C., *supra*.

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