October 26, 2015

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps. (File No. S7-14-15)

Dear Sir or Madam:

Better Markets[1] appreciates the opportunity to comment on the above-captioned proposed rule ("Proposed Rule" or "Proposal") issued by the Securities and Exchange Commission ("SEC" or "Commission").[2]

The Proposal would implement Section 763(a) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[3] That provision makes it unlawful for any security-based swap ("SBS") dealer or major SBS participant (collectively, "SBS Entities") to permit associated persons subject to a statutory disqualification to effect, or be involved in effecting, SBS transactions on behalf of the entity, **except to the extent otherwise specifically provided by rule of the Commission.** The Proposal establishes a process through which SBS entities may apply to the Commission for an order permitting associated persons to engage in SBS transactions on their behalf notwithstanding statutory disqualifications.

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1 Better Markets, Inc. is a nonprofit organization that promotes the public interest in the domestic and global capital and commodity markets. It advocates for transparency, oversight, and accountability in the financial markets.

2 Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons To Effect or Be Involved in Effecting Security-Based Swaps, 80 Fed. Reg. 51,684 (Aug. 25, 2015) (to be codified at 17 C.F.R. pt. 201).

3 Section 764 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, *codified at* 15 U.S.C. § 78j-4 (2010).

Although the proposal is well-designed in many respects, it suffers from two significant weaknesses: It delegates too much authority over exemptions from statutory disqualifications to other regulators and self-regulatory organizations (SROs). In addition, it unwisely allows associated person entities to be involved in SBS transactions while an application for relief from a statutory disqualification is pending, but **before** the Commission has determined that an exemption is in the public interest. Finally, we urge the Commission to adopt stronger approaches in certain areas, and not to weaken some of the well-chosen provisions already in the Proposal.

COMMENTS

1. The Commission should be guided by several general principles as it finalizes its Proposal.

First, one of the most fundamental and important features of any regulatory framework is a registration or licensing regime that includes strong disqualification standards. It is well-established that such requirements are necessary and appropriate to protect the public from market participants who are unfit to engage in certain financial activities. Fitness in this context means not simply having the requisite knowledge, training, and experience, but even more importantly, having a demonstrated commitment to complying with the law and a track record of doing so. Simply put, those who commit serious violation of the law can and should be disqualified. That's what Congress has said and intended in Section 764 of the Dodd-Frank Act.

Second, a strong fitness regime that includes disqualification standards is especially important in the derivatives markets, where the potential for abuse is high and where the destructive power of misconduct is potentially enormous. Because derivatives are so complex and poorly understood by even sophisticated market participants, dishonesty or corruption in these transactions can be particularly difficult to detect and deter. It is therefore critical that those who are trusted to engage in these transactions meet the highest possible standards of fitness and integrity.

In addition, because derivatives transactions can contribute to dramatic chain reactions in the financial markets, the consequences of incompetent, reckless, or illegal behavior can be profound. During the financial crisis of 2008, swaps and SBS played a central role in creating a global economic calamity. Swaps created significant contagion risk by linking the fates of seemingly unrelated firms to one another. The unique capacity of swaps to transfer risk between firms, and the sheer size and concentration of the swaps market, meant that trouble in one market sector could trigger a chain of major financial firm failures. Swaps were ultimately a key driver of massive taxpayer-funded bailouts to firms that few had identified as systemically risky.

Congress responded to both of these concerns by establishing a new and comprehensive regulatory framework for SBS in the Dodd-Frank Act, and it clearly recognized the need for fitness standards in this marketplace. Thus, Section 764 clearly and

broadly declares it to be unlawful for an SBS entity to allow a disqualified associated person to effect or even be involved in effecting SBS transactions, absent a regulatory exemption.

Third, exceptions from general rules should always be interpreted and applied narrowly, to preserve Congress's primary objectives and to ensure that regulatory implementation does not "frustrate the announced will of the people."[4] While this rule is most often applied in the context of statutory construction, where a legislative exemption is found, it should apply with equal force when an agency is attempting to fashion regulatory exemptions to general statutory prohibitions.

Finally, the Commission should not be swayed by claims that unless it minimizes the hurdles facing those who seek exemptions from statutory disqualifications, the SBS industry will suffer hardships and "business disruptions." This is one of the claims that the SEC has heard in connection with the Proposed Rule.[5] The guiding light for the SEC in all of its rulemaking endeavors must be protecting investors and preserving the integrity of our financial markets for the public good, not minimizing costs, inconvenience, or disruptions in the financial services industry.

2. The SEC must not delegate its authority to determine whether an exemption from disqualification is appropriate.

Under the Proposed Rule, a disqualified person or entity can obtain an exemption from a statutory disqualification, no matter how egregious the underlying misconduct, without even undergoing independent scrutiny by the Commission.[6] The Proposed Rule allows this if the CFTC, the National Futures Association, or another self-regulatory organization has reviewed the facts and circumstances of the disqualification and made an affirmative determination that the person should be permitted to continue activities within the jurisdiction of the other regulatory agency or SRO. Under these circumstances, rather than submit an application to the Commission, the SBS Entity would simply have to file a notice.[7]

This is an unacceptable approach, one that improperly delegates the SEC's power and authority over important disqualification determinations to other regulators, and even worse, self-regulatory organizations. It is flawed on a number of levels. First and foremost, it does not ensure that applications for an exemption from disqualification will be subject to strong, consistent, and relevant considerations under the securities laws. As Commissioner Stein noted in her dissent to the Proposal, other regulators administer different statutory

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4 *Commissioner v. Clark*, 489 U.S. 726, 739 (1989) (rejecting an argument for an exception under the Internal Revenue Code for payments normally treated as dividends) (quoting *Phillips v. Walling*, 324 U.S. 490, 493 (1945)).

5 80. Fed. Reg. 51,684, 51694-95.

6 *Id.* at 51,686.

7 *Id.* at 51,689.

schemes and have different priorities.[8] Only the SEC can fully and faithfully discharge its duty to protect investors under the securities laws, including the provisions relating to the SBS markets.

Reliance on SRO determinations is especially objectionable, since SROs invariably bring a fundamental conflict of interest to bear on such judgments. They are ultimately controlled by their industry members, and they exist fundamentally to serve those members' interests. They simply will not bring the same rigor and overarching concern for investors and market integrity as regulatory agencies will when assessing an associated person's fitness to continue working in a certain capacity.

Moreover, the justifications for the approach offered in the Release are unconvincing. The Commission apparently believes that "it would not be necessary for the Commission . . . to re-examine an event for which relief has already been granted."[9] This is untrue for the reasons articulated above: It is necessary for the Commission to exercise its judgment in each case to ensure that the policies underlying the securities laws are fulfilled.

The Release also asserts that the delegation will result in more consistent treatment of associated persons across different financial market sectors. The Release explains that it would generally be "anomalous" for a person to be able to engage in some transactions with some investors and yet be barred from engaging in SBS transactions with others.[10] But this type of regulatory consistency is a poor reason for the SEC to surrender its authority and responsibility to others. In fact, the hypothetical in the Release proves the point: The premise of that scenario is that the SEC might indeed reach a different conclusion than another regulator or SRO and deny an exemption from statutory disqualification where others have granted it. And in that case, the **inconsistent** outcome is presumptively better for investors and market integrity under the securities laws. Indeed, regulatory consistency is often a prescription for a race to the bottom—and that threat exists under the Proposed Rule.

3. Providing exemptive relief for entities while an application is pending conflicts with statutory language and intent, and inappropriately tilts the process in favor of industry rather than investors.

The Proposed Rule would automatically grant exemptive relief from disqualifications for 30 days to give SBS Entities the opportunity to assemble an application for an associated person to continue engaging in SBS transactions notwithstanding the disqualification, and for another six months while the SEC is evaluating the application. This is the wrong approach.

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8 Kara Stein, Commissioner, Securities and Exchange Commission, Statement on Final Rules for Security-Based Swap Dealer and Major Swap Participant Registration and on Proposed Rules for Applications to Waive Title VII Statutory Disqualifications (Aug. 5, 2015).

9 80. Fed. Reg. 51,684, 51698.

10 *Id.*

As a threshold matter, the SEC has at least correctly decided **not** to afford this relief during the application process for associate persons who are natural persons. It should resist any urgings from commenters to alter this decision and provide natural persons the same automatic relief from disqualification during the application process that the Proposal would allow for entities. As to entities, the SEC should reverse course and provide that the disqualification will remain in effect until the Commission makes its determination. This would more faithfully implement Congressional language and intent, and it would better protect our SBS markets from the potential harm arising from unscrupulous actors.

With respect to the law, ignoring a statutory disqualification for up to seven months pending the application and review process is inconsistent with what Congress clearly intended in Section 764(a) of the Dodd-Frank Act. That provision clearly and emphatically states that "it shall be unlawful" for an SBS Entity to allow associated persons with statutory disqualifications to engage in or be involved with SBS transactions. Until the Commission reviews the facts and circumstances and makes a judgment about the applicant's fitness to engage in SBS transactions, the applicant is simply and literally disqualified for purposes of Section 764. And until the Commission reaches a decision, the applicant presumptively poses precisely the threat to market integrity that the statute was attempting to mitigate.

Once again, the Commission's argument in favor of this approach is unpersuasive. The Release explains that the Commission is concerned about the potential for business "disruption" to SBS entities and to the SBS market if those entities are required to cease operations, even temporarily, because they cannot utilize the services of their disqualified associated persons.[11] Such pragmatic concerns centered on the industry's welfare cannot overcome the plain language and intent of the governing statutory provision, Section 764. Nor can those industry-focused concerns justify a policy or approach that exposes investors and the markets to the potentially "disruptive" effects that can arise from unscrupulous conduct by disqualified persons—those with a demonstrable history of law violations. Moreover, the harm cited in the Release is speculative and in fact incredible. It is more plausible to believe that if an associated entity cannot serve because of a disqualification, other market participants will fill the resulting void with a minimum of disruption.

In any event, if those disruptions actually were to occur, then the industry would find ways to adapt, by creating back-up plans, redundancies, or other measures. In short, the appropriate regulatory response is to insist on industry adaptation, not yield to the wishes of industry in a way that poses a threat to investors and the markets.

4. <u>The Commission should strengthen some aspects of the Proposal and resist calls to weaken others.</u>

In response to a number of questions and issues raised throughout the Release, we urge the Commission to adopt the following approaches in several areas:

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[11] 80. Fed. Reg. 51,684, 51695.

A. Promote transparency by making applications and supporting materials public. Under the Proposal, only orders reflecting the Commission's final disposition of an application for exemption would be made publicly available. The Commission should require that all applications and supporting materials be made public as well. This would promote transparency, thus ensuring that the public understands the Commission's handling of such applications and can influence the process if it appears to be too lenient in favor of allowing disqualified persons to serve in the SBS marketplace. This step is especially important in light of the Commission's far too secretive approach to the waiver process for other regulatory disqualifications.[12] A more transparent approach in this context will help restore the public's confidence in the SEC's oversight of market participants more generally.

B. Adopt a ten year look-back period. The Commission should require applicants for exemption to address disciplinary events going back ten years, not just five. This provides greater protections in accordance with the goals of Section 764, and it better reflects the ten-year look back period found in other provisions of the securities laws dealing with disqualifications.

C. Continue to include entity associated persons. Although the CFTC has defined "associated person" to include only natural persons and not entities, this is no justification for narrowing the Proposed Rule and excluding entities from the prohibitions in Section 764. The Proposal embodies the correct approach on this issue, as it reflects the relevant statutory language and intent and better serves its underlying purposes. These factors outweigh any possible benefit that consistency between the CFTC and SEC approaches might confer.

D. Continue to provide that inaction on an application means denial. The Proposed Rule correctly provides that if the Commission has not rendered a decision on an application within 180 days, the temporary exclusion expires and the applicant becomes subject to the disqualification. This is the correct "default" approach, and the Commission should not amend the Proposal to provide that inaction on an application automatically results in its being granted.

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[12] *See* Kara Stein, Commissioner, Securities and Exchange Commission, Remarks Before the Consumer Federation of America's 27th Annual Financial Services Conference (Dec. 4, 2014).

CONCLUSION

We hope these comments are helpful as the Commission finalizes the Proposal.

Sincerely,

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