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Via Electronic Submission: rule-comments@sec.gov

Elizabeth M. Murphy
Secretary of the Commission
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants - Proposed Rule (File Number S7-25-11) (the "Proposing Release")

Dear Ms. Murphy:

We appreciate this opportunity to comment on the rules recently proposed by the Securities and Exchange Commission (the "Commission") under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act") relating to business conduct standards for security-based swap dealers and major security-based swap participants[1] (the "Proposed Rules"). Our comments below all specifically relate to the Proposed Rules under Section 764 of the Act[2] regarding transactions of SBS Dealers with Special Entities (as defined in the Act).

As described in more detail below, we respectfully request that the Commission: (1) continue its good progress in clarifying and limiting what it means for an SBS Dealer to "act as an advisor to a Special Entity" and further refine the means by which parties to a swap can agree that the SBS Dealer is not acting as an advisor to a Special Entity; (2) recognize the special role performed by a qualified "special representative" who is an employee of a Special Entity and streamline the requirements related to that role; (3) permit a reasonable approach to certain compliance documentation required under the Proposed Rules; and (4) reconsider giving appropriate effect to the limiting language in Section 15F(h)(5)(A)(i) of the Exchange Act regarding the types of Special

[1] For ease of reference, we use the term "SBS Dealer" to include both security-based swap dealers and major security-based swap participants.
[2] Section 764 of the Act adds new Section 15F to the Securities Exchange Act of 1934, as amended (the "Exchange Act").

Entities to which the independent representative requirement applies in the context of transactions between an SBS Dealer and a Special Entity.

As a general matter, while we support the Commission's effort to balance the investor protections called for by the Act with the need to maintain active buy-side participation in our markets, we remain concerned that, from the perspective of those large, sophisticated Special Entities that are themselves highly knowledgeable about derivatives and derivatives markets, some of the requirements suggested by the Commission will create undue impediments to dealers transacting with them and/or will unduly increase the cost of such transactions (*see, e.g.*, Part II.B below). This may have significant adverse effects both on the investment activities of, and financial management by, these Special Entities in their provision of critical services and retirement benefits to a broad range of U.S. citizens, and on markets in general. "Special Entity" is a broadly inclusive term that encompasses entities of widely varying sizes, sophistication levels, and experience in derivatives trading. As such, different Special Entities require significantly different levels of investor protection. We believe that the final rules can and should appropriately reflect this reality.

We are grateful for the Commission's efforts to build upon the companion rulemaking of the Commodity Futures Trading Commission ("CFTC" and, together with the Commission, the "Commissions") on business conduct rules for swap dealers and major swap participants and to address concerns expressed in comments received by the CFTC.[3] Unfortunately, it remains difficult to tell where the Commissions might be thinking alike and acting together and where they might be heading in different directions. From the perspective of our clients that are Special Entities, there is only one good answer here, and that is maximum coordination of the two sets of business conduct rules. Otherwise, it is likely that differences in regulatory approach, no matter how well motivated, will make no practical difference. Dealer willingness to do business, counterparty documentation and the all-important issue of the cost of trading will likely be dictated by the more onerous scheme of regulation on each particular point. Thus, we urge the Commissions to continue and complete the difficult business of coordination and, in the process, to resist any impulse to resolve each difference in favor of greater regulation, as opposed to market efficiency.

I. Proposed Rule 15Fh-2(a) – Requirements for SBS Dealers Acting as Advisors to Special Entities

In Proposed Rule 15Fh-2(a), the Commission proposes to clarify what it means for an SBS Dealer to "act as an advisor to a Special Entity" for purposes of Section 15F(h)(4) of the Exchange Act. In so doing, the Commission has followed the CFTC's lead in defining this phrase to mean "recommend" a trade or trading strategy. The Commission has built on the CFTC definition by providing a means whereby the SBS Dealer and Special Entity can establish through representations and disclosures that the SBS Dealer is not acting as an advisor. This is a practical and welcome

[3] Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 75 Fed. Reg. 80638 (Dec. 22, 2010).

addition that likely makes the definition workable, and we support the addition to the definition. At the possible risk of confusing our support, we would like to make a general comment on the overall definition and a technical comment on the content of the proposed representations to be given by the Special Entity.

As noted in our comment letter to the CFTC in connection with its companion rulemaking,[4] we continue to believe that the basic definition of "acts as an advisor" to mean "recommends" is overly broad and unwise, notwithstanding the practical solution to this problem provided in the Commission's proposal. The equation is not correct. Acting as an advisor requires a more formal, acknowledged agency, as part of a relationship of trust and confidence. Recommending can happen in many contexts, including mere marketing or market chatter.[5] The difficulty in allowing the incorrect equation to stand is that it may chill market communications, to the detriment of individual participants or the markets themselves, or it may possibly inform other legal standards in a mischievous and unintended way, likely chilling dealer interactions with Special Entity counterparties in the process. In the Proposing Release, the Commission itself has questioned whether more of a relationship than mere recommending is required in order for an SBS Dealer to be considered to be "acting as an advisor."[6] We believe the answer is clearly, "Yes" and would suggest coupling a more restrictive basic definition with the proposed process whereby SBS Dealers can establish that they are not acting as an advisor for Special Entity counterparties.

As to the process envisioned by Proposed Rule 15Fh-2(a), it arguably suffers from having to respond to an overly broad definition in the first place. That is, in the process of having a Special Entity acknowledge the lack of investor protection that it would otherwise receive were the SBS Dealer acting as an advisor, the rule might go too far and ask the Special Entity to surrender basic legal protections. This is because the Special Entity is asked to represent that it is not "relying" on recommendations from the SBS Dealer. Reliance is one of the essential elements of securities fraud actions, including civil actions under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. It does not take much legal imagination to envision a dealer trying to leverage the representation by defending a fraud action on the basis that the Special Entity has not relied on any statement made or

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[4] Letter of Christopher Klem and Molly Moore, Ropes & Gray, LLP, to the CFTC, Feb. 22, 2011, *available at* http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27805&SearchText=klem (referred to herein as the "Ropes & Gray Letter").

[5] We note that the relevant language in the Act appears to implicitly acknowledge that "acting as an advisor" is distinct from making a recommendation. Section 15F(h)(4)(C) of the Exchange Act provides that "[a]ny security-based swap dealer that *acts as an advisor* to a Special Entity shall make reasonable efforts to obtain such information as is necessary to make a reasonable determination that any security-based swap *recommended* by the security-based swap dealer…." (emphasis added).

[6] Among other possibilities, the Commission has inquired about crafting a basic definition that tracks the definition of "investment adviser" in Section 202(a)(11) of the Investment Advisers Act of 1940, as amended. Thus, someone acting as an advisor with respect to security-based swaps would be "any person who, for compensation, engages in the business of advising special entities, as to the value of security-based swaps or as to the advisability of security-based swaps or trading strategies involving security-based swaps."

not made by the dealer, much as the dealers have long asserted the sophistication of buy-side institutions as a defense to all forms of alleged fraud (without much judicial success to this point). Thus, as a purely technical matter, we suggest that it would be better to have the Special Entity represent under Proposed Rule 15Fh-2(a)(1)(i) that the Special Entity acknowledges that the SBS Dealer is not acting as a advisor to the Special Entity. This is one instance in which a conclusory representation is likely better than an attempt to restate the legal test.

In offering both our general and our specific suggestions for possible improvement, we reiterate our support for the Commission's effort to provide a process-based means of achieving clarity on the question of whether an SBS Dealer is acting as an advisor.

II. Proposed Rule 15Fh-5 – Requirements for SBS Dealers Acting as Counterparties to Special Entities

A. The Commission Should Recognize the Special Role Performed by Qualified Independent Representatives Who Are Employees of the Special Entity

Under the Exchange Act and Proposed Rule 15Fh-5(a), an SBS Dealer acting as a counterparty to a Special Entity must have a reasonable basis to believe that the Special Entity has a qualified independent representative meeting various criteria. As has been noted by both Commissions, legislative history makes it clear that the test of independence relates to independence from the SBS Dealer and that role can be performed by a qualified employee of the Special Entity, or, presumably, a controlled affiliate of the Special Entity (an "Employee Representative"). The very structure of Section 15F(h)(5)(A)(i) of the Exchange Act makes the same points. Most of the requirements for an independent representative relate to the potential for agency risk where the independent representative is an independent contractor and possibly depends on the SBS Dealer for business. The Employee Representative passes all of the tests, except for the knowledge requirement of subsection (I) and the requirement of no statutory disqualification in subsection (II), with flying colors on the basis of the basic employment relationship, with the control and duties implicit therein.

Given this special position of the Employee Representative, we encourage the Commission to create presumptions that allow SBS Dealers to reasonably conclude that the requirements of Proposed Rule 15Fh-5(a)(3),(4) and (5) are met for Special Entities relying on an Employee Representative. Specifically, with respect to Proposed Rule 15Fh-5(a)(5), we note the somewhat troubling wording difference between the Commission's proposal, which tracks the Act in requiring written representations as to pricing from an independent representative to a Special Entity, and the CFTC's proposal,[7] which appears on its face to permit a broader range of approaches to the interactions over

[7] Proposed 17 CFR §23.450(b)(6).

pricing between the Special Entity and its independent representative. Obviously, the CFTC's approach is more conducive to allowing an Employee Representative to act normally within the scope and dictates of his or her regular employment and is more favorable in this regard. However, the Commission has expressed a preliminary inclination toward an analogous approach that would not set a specific documentation requirement. We point out the obvious – an extensive documentation requirement imposed upon an Employee Representative evaluating trades on a busy trading desk, to be enforced through the diligence process of an SBS Dealer would likely be the kind of intrusive and overbearing regulation that should be avoided. We therefore encourage the Commission in its inclination toward a practical solution, particularly a solution that recognizes the special position of Employee Representatives, and hopefully a solution to be shared in the companion final rule from the CFTC.

B. The Commission Should Permit a Reasonable Approach to Compliance Documentation

The Commission should permit a reasonable approach to an SBS Dealer's documentation of its determination that a Special Entity has a qualifying independent representative. Under the Exchange Act and Proposed Rule 15Fh-5(a), an SBS Dealer acting as a counterparty to a Special Entity must have a reasonable basis to believe that the Special Entity has an independent representative that meets six criteria (seven, where the Special Entity is an ERISA plan).

We observe that the sophisticated Special Entities to which we have referred in this letter normally will not face any significant issues in satisfying the criteria. Indeed, the various criteria will serve to rigorously establish the sophistication of these Special Entities. We are concerned, however, that trade-by-trade documentation of the criteria, as well as of the representations discussed above establishing that the SBS Dealer is acting as counterparty and not as advisor, could adversely impact the speed of trade execution for Special Entities and could needlessly turn each trade into a heavily-papered compliance exercise. As noted in the Ropes & Gray Letter, we would hope that, in adopting final rules, the Commission will clarify that an SBS Dealer will be able to meet its burden of confirming the resources available to a Special Entity through appropriate representations provided by that entity periodically, certainly no more frequently than annually, and in all events outside of the time pressures of a particular trade. Again, we believe that such a rule of reason should apply all the more to SBS Dealers in their dealings with those Special Entities with substantial internal expertise in swaps. We believe that such a reasonable approach to documentation of determinations is well within the authority provided by Section 15F(i) of the Exchange Act.

C. The Commission Should Seek Clarification Regarding Application of the Independent Representative Requirement to All Special Entities

We respectfully urge the Commission to revisit the question of which Special Entities are required to have an independent representative when transacting with SBS Dealers. In pre-rulemaking comments to the Commissions' respective rulemakings[8] and in the Ropes & Gray Letter, we highlighted the language in Section 731(h)(5)(A)(i) of the Act (the companion provision to Section 15F(h)(5)(A)(i) of the Exchange Act) that limits the independent representative requirement to certain types of governmental entities. In its Proposing Release, the Commission has noted this ambiguity and, like the CFTC, concluded that the limiting language in the statute should be ignored.[9]

We agree with the Commission's analysis of the particular reference, and acknowledge and sympathize with the interpretative challenge that the analysis presents. However, we are concerned that the Commission's decision to ignore the limitation is the wrong one. It seems clear that the reference was intended by Congress to limit the independent representative requirement to a subset of governmental entities, presumably ones all included within the definition of a "Special Entity." Of course, it is not now appropriate for the Commission to go back and guess which entities were intended to be covered by the limiting language in the absence of unambiguous legislative history and conclusive evidence of a scrivener's error (and perhaps not even then). However, it seems equally inappropriate for the Commission to declare that the reference is a mistake to be ignored entirely. Indeed, the clearer case for a mistake is that the entities referenced are not all Special Entities under the Act and not that there is a limiting reference in the first place.

There are at least three other possibilities for resolving the statutory ambiguity: (i) interpreting the de facto independent representative requirement as applying to both those referenced governmental entities that are Special Entities and those that are not, (ii) interpreting the independent representative requirement to be generally inapplicable (as clearly most Special Entities were not intended to be covered in the reference), and (iii) interpreting the requirement as applying to only those referenced governmental entities that are Special Entities. To be sure, the first two of these possibilities pose their own problems of statutory interpretation,[10] and yet all three are logically more compelling than ignoring the reference altogether because it is simply unclear. In an ideal world, the Commission would affirmatively seek clarification in the form of further Congressional action to correct the apparent error, instead of defaulting to the least likely resolution (taking a

[8] Comments of Christopher Klem, Ropes & Gray, LLP, to the CFTC, Sept. 2, 2010; comments of Christopher Klem, Ropes & Gray, LLP, to the SEC, Sept. 2, 2010.

[9] Please see the discussion at Section II.D.5.a of the Proposing Release.

[10] The first possibility is contradicted by the lead-in to Section 15F(h)(5)(A) of the Act, which expressly refers to swaps with Special Entities. The second begs the question, discussed in detail in our pre-rulemaking letter to the CFTC and noted in the Proposing Release, of whether the special rule for ERISA plans in Section 15F(h)(5)(A)(i)(VII) is evidence of the mistake that the Commission now asserts or, as seems more likely, simply reflects the order in which last-minute changes were added to the Act shortly before its passage.

statutory provision of intended narrow application and making it broadly applicable). Failing to take this step, the Commission should apply the reference so as to give greatest effect to both words and apparent intent, by preserving the reference in the statute and interpreting it to cover those included governmental entities that are Special Entities.

The Commission has cited legislative history[11] for the proposition that, whatever the wording of the independent representative requirement, it was intended to apply to all Special Entities. We are unable to recreate in precise order the final events that transpired in Congress in the hurried days just before adoption of the Act for presentation to the President. We do note that the limiting reference was a relatively late insertion in the Act, raising the obvious possibility that it could have actually followed in time earlier committee reports describing the then state of legislation. In this regard, it is not at all unusual for final Congressional reports to describe points contained only in superseded drafts of legislation and not reflected in actual law. Legislative history is sometimes helpful in describing the intent of ambiguous provisions, but it cannot remove from a statute positive provisions that beg explanation, interpretation and effect.

We appreciate the Commission's attention to these comments.

Sincerely yours,

/s/ Christopher A. Klem
Christopher A. Klem

/s/ Molly Moore
Molly Moore

[11] *See* H.R. Conf. Rep. 111–517 (June 29, 2010) (''When acting as counterparties to a pension fund, endowment fund, or state or local government, dealers are to have a reasonable basis to believe that the fund or governmental entity has an independent representative advising them.''), cited in the Proposing Release at § II.D.5 and n. 214.