August 26, 2011

By electronic submission to www.sec.gov

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, File No. S7-25-11 (the "Proposed Rules")

Dear Ms. Murphy:

The Futures Industry Association ("FIA"), the International Swaps and Derivatives Association, Inc. ("ISDA") and the Securities Industry and Financial Markets Association ("SIFMA") (together with FIA and ISDA, the "Associations")[1] appreciate the opportunity to submit this letter to the Securities and Exchange Commission (the "Commission") with respect to the Commission's proposed rules implementing provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") regarding business conduct standards for security-based swap dealers ("SBSDs") and major security-based swap participants ("MSBSPs," and together with SBSDs, "SBS Entities").[2] Our members comprise many of the most active participants in the swap and security-based swap ("SBS") markets, and the Associations strongly support Dodd-Frank's goals of increasing transparency, mitigating systemic risk, and enhancing practices in those markets.

---

[1] For background on the Associations, please consult the attached Appendix.

[2] Release No. 34-64766, 76 Fed. Reg. 42396 (July 18, 2011) (the "Proposing Release").

The Proposed Rules implement statutory provisions substantially identical to those addressed by the Commodity Futures Trading Commission (the "CFTC") in its December 2010 proposal for external business conduct standards (the "CFTC Proposal") for swap dealers ("SDs") and major swap participants ("MSPs" and together with SDs, "Swap Entities")[3] and related rulemakings under Dodd-Frank.[4] We appreciate the Commission's efforts to take into account the public comments on the CFTC Proposal in preparing the Proposed Rules. As currently drafted, the Commission's proposal avoids many of the pitfalls and unintended consequences presented by the CFTC Proposal. We believe the Commission's proposal is generally consistent with the legislative intent of Dodd-Frank and provides appropriate protections for SBS counterparties, while providing needed clarity as to the roles, responsibilities and expectations of SBS counterparties.[5]

It is critical that swap and SBS market participants, who by and large are sophisticated institutional investors, large corporate end users and financial intermediaries, retain the ability to establish, without ambiguity, the nature of their relationships. While it is clear that Congress did not intend for the SBS market to operate as a *caveat emptor* marketplace, it is equally clear that Congress specifically intended to distinguish advisory relationships from the more common principal-to-principal relationships that characterize the swap and SBS markets. We believe that the Proposed Rules balance these objectives effectively, although, as described in greater detail below, certain clarifications are necessary, including clarifications needed to enable parties to negotiate and execute SBS transactions in a timely fashion without subjecting end users to undue (and unwanted) market risk during changing market conditions.

In addition, given the range of institutions likely to become subject to regulation as SBS Entities, including banks, broker-dealers and certain types of investment funds, internal business conduct standards for SBS Entities under Dodd-Frank must be flexible enough to accommodate the different organizational structures in place at SBS Entities, many of which are necessary to comport with requirements imposed by other U.S. and foreign regulators. The Proposed Rules generally accommodate these considerations, with the exception of certain aspects of the rules relating to Chief Compliance Officers ("CCOs"), as discussed below.

Finally, the Commission has specifically urged market participants to consider a host of specific questions related to particular proposals. Accordingly, in our comments below

---

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

[4] CFTC Proposed Rules, Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71397 (Nov. 23, 2010); Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71391 (Nov. 23, 2010); and Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant, 75 Fed. Reg. 70881 (Nov. 19, 2010).

[5] We will be providing the CFTC a copy of this letter as well as a separate comment letter urging the CFTC to harmonize its rules with the SEC's Proposed Rules to as great an extent as possible.

we have sought to address some of those questions, as well as to suggest ways to clarify certain ambiguities identified by the Commission in its Proposing Release.

DISCUSSION

For convenience, we have organized our comments and recommendations generally in the order in which they are addressed in the Proposed Rules.

I. Scope

A. Opt-Out Regime

The Commission requested comments on whether certain counterparties should be able to opt out of any additional protections meant to benefit such counterparties. We believe that counterparties should be permitted to reach a judgment that the burdens imposed by the Proposed Rules, as measured in terms of costs, delays in execution, and requirements to make detailed representations and disclose information to the SBS Entity, outweigh the benefits that such counterparties would receive. Recognizing that status as an eligible contract participant ("ECP") is the minimum necessary to transact in SBS off of an exchange,[6] we recommend that the Commission set the threshold for opt-out rights at "qualified institutional buyers" as defined in Rule 144A under the Securities Act of 1933 and entities having total assets of $100 million or more.

B. Pre-Compliance Date SBS

We support the Commission's clarification that the Proposed Rules would not apply to SBS executed prior to the compliance date for the rules.[7] In addition, in our view the Proposed Rules should not generally apply to amendments to, and other lifecycle events arising under, SBS after the effective date of the rules. Amendments to existing transactions typically do not alter the risk and other characteristics of a transaction sufficiently to merit application of the Proposed Rules and, in many cases, must be implemented quickly (or occur automatically) to respond to market, legal and other developments such that their purpose could be frustrated by application of the Proposed Rules.

---

[6] The Proposed Rules require that an SBS Entity verify that a counterparty whose identity is known to the SBS Entity meets the eligibility standards for an ECP before entering into an SBS with that counterparty other than on a registered national securities exchange ("NSE") or registered security-based swap execution facility ("SBSEF"). The Commission and the CFTC are jointly proposing rules and interpretive guidance under the Securities Exchange Act of 1934 (the "Exchange Act") and the Commodity Exchange Act (the "CEA") to further define the term "eligible contract participant."

[7] Proposing Release at 42401.

C. Inter-Affiliate SBS

The Proposed Rules are generally intended to protect arm's-length counterparties and advisory clients of SBS Entities. These policy objectives are irrelevant in the context of transactions entered into between affiliates to manage risk within a commonly controlled corporate group, where the interests of the contracting parties are generally aligned. Indeed, the same personnel are often involved for both parties in such transactions. Imposing the Proposed Rules on such inter-affiliate transactions would merely impose additional costs and delays on ordinary course risk management activities, without corresponding benefits.

II. Definitions

A. Advisor to Special Entity

The Commission has proposed a definition of the phrase "act as an advisor to a special entity" that would enable prospective counterparties to clarify, by agreement, that their relationship is one of arm's-length principals, rather than an advisory relationship. Specifically, an advisory relationship would not exist in circumstances where: (i) the special entity represents in writing that it will not rely on recommendations provided by the SBSD and will instead rely on advice from a qualified independent representative; (ii) the SBSD has a reasonable basis to believe that the special entity is advised by a qualified independent representative; and (iii) the SBSD discloses to the special entity that it is not undertaking to act in the best interests of the special entity.[8] We strongly support the Commission's proposed inclusion of this safe harbor.

In our view, enabling contracting parties to specify the nature of their relationship is critical and Congress clearly contemplated that SBSDs would do so.[9] Market participants must have the ability to agree, and to specify, the services they wish to obtain, or do not wish to obtain, and to manage the associated costs and other incidents of their relationships. Even more important, no market participant is well-served by a regime in which SBSDs are deemed (in hindsight) to have responsibilities of which they were unaware or in which counterparties are proceeding under misapprehensions as to who, if not the counterparty, is responsible for evaluating the advisability of a prospective transaction.

We believe it is indisputably preferable to foster a regime in which parties are operating with a clear understanding of their roles, responsibilities and expectations, and mistakes

---

[8] Proposed Rule ("PR") 15Fh-2(a). As a practical matter, we would expect that the relevant representations and disclosures required under the Proposed Rules would be made in the context of the parties' master agreement and deemed to be repeated for each transactions executed thereunder, in which case we would expect that the safe harbor would be deemed to apply to each of those transactions and any associated discussions or negotiations between the parties.

[9] See Exchange Act Section 15(h)(5)(A)(ii) (requiring an SBSD to disclose to a special entity in writing the capacity in which the SBSD is acting).

are avoided, than to foster confusion and uncertainty which may well lead to mistakes, with the goal of preserving a possible cause of action for possible resulting losses. The remedy cannot be more important than the goal of fostering desirable market conduct and avoiding confusion. As the Associations noted in their comment with respect to the CFTC Proposal, uncertainty could lead SBSDs to avoid SBS transactions with special entities and would, at a minimum, chill the exchange of desirable and beneficial communications.

In order to determine whether it will need to rely on the safe harbor, an SBSD must first be able to determine whether or not any particular communication would constitute a "recommendation" and hence make the SBSD an advisor. The Commission provides, in accordance with the Financial Industry Regulatory Authority's ("FINRA") approach, that "the more individually tailored the communication to a specific customer or a targeted group of customers about a security or group of securities, the greater the likelihood that the communication may be viewed as a recommendation."[10] We believe that such guidance in the Proposing Release is helpful but does not provide sufficient clarity. The term "recommendation," for purposes of the business conduct requirements, should not cover communications to groups of customers or to investment managers with multiple clients, unless the communication is tailored to a member of the group or to a specific client known to the SBSD. Absent such circumstances, a communication cannot reasonably be regarded by the recipient as tailored to its particular circumstances in any meaningful way. At a minimum, we believe the Commission should clarify that a recommendation must be tailored to the circumstances of a known special-entity counterparty before giving rise to advisor status. Without this clarification, general communications to investment advisers that may or may not have special entities as clients could result in the SBSD unknowingly becoming an advisor.

In addition, we request that the Commission define a "recommendation" that would give rise to an advisory relationship as one that involves advice as to the value of an existing or proposed SBS or as to the advisability of executing an SBS or implementing a trading strategy involving SBS. This definition would help make the Proposed Rules' definition of "act as an advisor" more consistent with the definition of an investment adviser under the Investment Advisers Act of 1940 (the "Advisers Act"), and with the definition of commodity trading advisor under the CEA, while also preserving the benefits of the safe harbor proposed by the Commission.[11] Similarly, we request that the Commission staff working on the Proposed Rule coordinate with the staff members working on the final rule for the Registration of Municipal Advisors,[12] the Municipal Securities Rulemaking Board (the "MSRB") and the CFTC because their respective rulemakings defining when a person will be regarded as an advisor should be as

---

[10] Proposing Release at 42415.

[11] See Advisers Act Section 202(a)(11) (definition of "investment adviser"). See also Proposing Release at 42425 (requesting comment regarding whether to define "advisor" in a manner consistent with the definition of investment adviser).

[12] See SEC Proposed Rule, Registration of Municipal Advisors, 76 Fed. Reg, 824 (Jan. 6, 2011).

consistent as possible with the definition of "acts as an advisor" in the business conduct standards for SBS Entities.

B. Independent Representative of Special Entity

We also support the Commission's inclusion of a clear and objective safe harbor to determine the independence of a special entity representative. As currently drafted, the Proposed Rules provide that a representative of a special entity would be deemed to be independent of an SBS Entity if two conditions are satisfied. First, the representative is not and, within one year, was not an associated person of the SBS Entity and second, the representative has not received more than ten percent of its gross revenues over the past year, directly or indirectly, from the SBS Entity.[13]

Because an SBS Entity will be required to identify its "associated persons" for other requirements under the Proposed Rules, the first prong of this independence test adds an important safeguard without imposing additional administrative costs on the SBS Entity. The second prong (the ten percent of gross revenues test), however, would entail an additional data collection effort, and as such, it should be carefully delineated to provide the appropriate protections without imposing undue costs. We suggest four clarifications/modifications:

- Only payments by or on behalf of the SBS Entity (not by or on behalf of any affiliates or other "associated persons") should be taken into account. As noted below, references to an SBS Entity cannot include "associated persons" in this context because it is simply not feasible for the parties to determine payments made by all the associated persons of an SBS Entity to the representative of the special entity. Nor do we believe that it was the Commission's intent to refer to associated persons in this way.

- Revenue computations should be determined as of the end of the representative's prior fiscal year rather than the proposed rolling 12 month look-back. We are concerned that a rolling look-back may not be workable in practice across all representatives and will complicate compliance with the Proposed Rules. Using the prior fiscal year instead would alleviate the burden of recalculating the representative's gross revenue prior to each SBS transaction and provide greater certainty for the special entity and the SBS Entity as to whether the representative satisfies the ten percent prong of the test. We believe this alternative approach would reduce compliance costs without having an appreciable adverse impact.

---

[13] PR 15Fh–2(c)(3).

- The Commission should confirm that payments to any affiliate (other than a wholly-owned subsidiary) of the representative should not be taken into account for purposes of this test.

- The Commission should confirm that, consistent with its general approach with respect to reliance on representations, an SBS Entity may rely on representations from the representative as to its gross revenues and whether payments that have been made to the representative equal or exceed the ten percent threshold.

C. Special Entity

In response to the Commission's request for comment as to whether clarification of the definition "special entity" is necessary, we propose the following clarifying changes.[14] These changes parallel our comments to the CFTC Proposal, and we believe they would mitigate the current ambiguities in the "special entity" definition.

- **Collective Investment Vehicles:** The Commission should clarify that collective investment vehicles do not become special entities merely as a result of the investment by special entities in such vehicles. Examples of such vehicles include bank collective trust funds that consist of assets of unrelated pension plans[15] and investment funds held 25% or more by Employee Retirement Income Security Act ("ERISA") plans and thus subject to ERISA.[16] The plain language of Dodd-Frank reveals the congressional intent to cover only employee benefit plans that act as counterparties to SBS Entities.[17] Indeed, it would be impossible for an SBS Entity to discharge the duties imposed on it by Dodd-Frank to every entity that participates in a collective investment vehicle. Furthermore, since many collective investment vehicles typically include a range of investors, including those that are not subject to ERISA, the inclusion of collective investment vehicles in the definition of special entity would inappropriately extend the additional special entity protections to investors that do not seek or need such protections.

- **Master Trusts:** The definition of "special entity" should encompass master trusts holding the assets of one or more funded plans of a single employer. Many employers combine one or more of their own pension plans into a master trust. Indeed, the assets of plans subject to ERISA's fiduciary responsibility requirements are generally held by

---

[14] Proposing Release at 42422.

[15] See, e.g., Section 3(c)(11) of the Investment Company Act of 1940 and Section 3(a)(2) of the Securities Act of 1933.

[16] See ERISA "Plan asset regulation," 29 CFR § 2510.3-101.

[17] See Exchange Act Section 15F(h)(2)(C)(iii) (defining "special entity," in relevant part, as "any employee benefit plan").

a separate trust and such a trust would typically enter into swaps with a counterparty. Such plans should also receive the protections provided by Dodd-Frank.

- **Plans Not Subject to ERISA:** The Commission should specify that plans that are not subject to ERISA should not be encompassed within the employee benefit plan prong of the "special entity" definition. Only those plans subject to the fiduciary responsibility provisions of ERISA—such as funded pension and welfare plans that are subject to extensive investment regulation by the Department of Labor ("DOL")—should be included in this prong, a result which we believe is consistent with congressional intent. Since Congress included a separate "governmental plans" prong in the definition of special entity, the "employee benefit plan" prong necessarily excludes governmental plans (both domestic and foreign) and should be read narrowly to include only employee benefit plans subject to ERISA. While the "governmental plans" prong of the special entity definition would cover U.S. governmental plans, the special entity definition should exclude (i) unfunded plans for highly compensated employees; (ii) foreign pension plans (including foreign-based governmental plans); (iii) church plans that have elected not to subject themselves to ERISA; (iv) Section 403(b) plans that accept only employee contributions; and (v) Section 401(a), 403(b) and 457 plans sponsored by governmental entities.

- **Endowments:** While "special entity" is currently defined under the Proposed Rules to include "any endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986," we respectfully recommend that the Commission address the scope of this prong of the "special entity" definition by clarifying that it is limited to an endowment that itself enters into swaps, including swaps to manage or generate returns for its investment portfolio, and does not encompass a non-profit organization, the assets of which may include an endowment or funds designated by it as an endowment. Healthcare, higher education and other non-profit organizations, as borrowers on a taxable or tax-exempt basis, are frequent users of swaps, including as hedges in connection with their borrowings. A non-profit organization's swap may be contractually payable from legally available sources, which may include funds designated by it as an endowment, or from another identified source. The proposed clarification would exclude such a non-profit organization, a result consistent with the definition of "special entity," which does not by its terms include non-profit organizations.

D. Associated Persons of SBS Entities

Under the Proposed Rules, the definitions of SBSD and MSBSP would include, "where relevant," an associated person of the SBSD or MSBSP.[18] The Commission indicates that

[18] "Associated person" includes (i) any partner, officer, director or branch manager, (ii) any person directly or indirectly controlling, controlled by or under common control with the SBSD or MSBSP and (iii) any employee of

(footnote continued on next page)

this is meant to clarify that, to the extent that an SBS Entity acts through, or by means of, an associated person, the associated person must comply as well with the applicable business conduct standards.[19] In this regard, we believe that the Commission should clarify that associated persons should be directly responsible only for complying with the disclosure and other rules involving interactions with counterparties. In contrast, associated persons should not be directly responsible for complying with internal business conduct standards, such as PR 15Fh-3(i) (supervision) and 15Fk-1 (CCOs), although the supervisory and compliance systems of SBS Entities should be required to address SBS activities conducted through, or by means of, associated persons (but should not reach the activities of associated persons generally, as PR 15Fh-3(i) appears to provide).

In addition, rather than addressing this issue through definitional provisions, which creates ambiguities regarding the application of many of the rules proposed (for example, whether payments by an associated person of an SBSD unrelated to the swap transaction to the representative of a special entity would be counted against the ten percent gross revenue limit for purposes of the independence test), we respectfully request that the Commission instead codify the clarification noted above by (i) defining "associated person" as an associated person of an SBSD or MSBSP through whom the SBSD or MSBSP acts and (ii) adding the term "associated person," where appropriate, in its rules.

II. Reliance on Representations

The Proposed Rules would permit reasonable reliance on counterparty representations with respect to several key business conduct requirements. We support the Commission's proposed approach. We believe it is consistent with relevant regulatory precedent generally and is essential to respecting the counterparty relationship because it does not require, absent any red flags, costly, time-consuming due diligence and intrusive inquiries by the SBS Entity into the affairs of its special entity or other counterparty.

The Commission has proposed two alternative approaches for determining the circumstances in which it would no longer be appropriate for an SBS Entity to rely on such representations without further inquiry. The first approach would permit an SBS Entity to rely on a representation from a counterparty unless it knows that the representation is not accurate. The second would permit an SBS Entity to rely on a representation unless the SBS Entity has information that would cause a reasonable person to question the accuracy of the representation. Under either approach, an SBS Entity could not ignore information in its possession as a result of

---

(footnote continued from previous page)

the SBSD or MSPSP, in each case subject to an exception for persons whose functions are solely clerical or ministerial. See Section 3(a) of the Exchange Act.

[19] Proposing Release at 42402-03.

which the SBS Entity would know that a representation is inaccurate.[20] Neither approach specifies the circumstances in which an SBS Entity is deemed to have knowledge of specific facts, and, in particular, if the test applies to the SBS Entity or to the individuals specifically involved in the SBS transactions.

In our view, the first of the two proposed standards for reliance on representations is preferable because it would provide greater legal certainty for SBS Entities concerning their business conduct obligations. Although certain standards contained in the Proposed Rules, such as status as an ECP, are mostly quantitative or objective, many other standards, such as the qualifications of a special entity's independent representative or the counterparty's ability to exercise independent judgment, are qualitative.[21] Judgments of this type are inherently subjective. The counterparty is uniquely positioned to make such judgments, based on its own experience with a particular independent representative or in the SBS market generally. Imposing a constructive knowledge standard on an SBS Entity in evaluating the accuracy of counterparty representations would put the SBS Entity in the position of second-guessing the counterparty's choice of independent representative and conducting further inquiries into the counterparty's own qualifications. Such inquiries are largely inappropriate outside the advisory context, and the counterparty is likely to view them as intrusive and unnecessary, particularly in the case of more standardized transactions for which the costs of resulting execution delays are unlikely to outweigh any protective benefits to the counterparty. In contrast, an actual knowledge standard would avoid these disincentives to transacting with special entities and other counterparties.

More importantly, we believe that the knowledge test should be applied only to individuals with knowledge of the SBS transaction. Information that may be available to parts of the SBS Entity organization that are not involved in the SBS transaction should not be imputed to the individuals involved in the SBS. Such an approach would respect the organizational structures and divisions within SBS Entities, while still requiring persons involved in SBS transactions to respond appropriately to red flags. We note that this approach would be consistent with the Regulation R precedent cited by the Commission,[22] in which a bank's "reasonable basis to believe" that a customer satisfies certain eligibility criteria is satisfied if the bank obtains a signed acknowledgment that the customer meets the applicable criteria and the *specific* bank or broker-dealer employee dealing with the customer does not have information that would cause the employee to believe that the information provided by the customer is false.[23]

---

[20] Proposing Release at 42403-04.

[21] We note that the recommendation in our comments on the CFTC Proposal (cited in fn. 58 of the Proposing Release) that the CFTC adopt a reasonableness standard for reliance on representations was limited to certain objectives qualifications, such as the counterparty's status as an ECP or a special entity representative's status as a QPAM. Given that the Commission has, however, proposed a single standard for reliance on representations across all the standards contained in the Proposed Rules, including qualitative ones, we believe that an actual knowledge standard is more appropriate.

[22] Proposing Release at fn. 58.

[23] Release No. 34-56501, 72 Fed. Reg. 56514, 56525 (Oct. 3, 2007).

III. Business Conduct Requirements: Counterparty Status

Under PR 15Fh-3(a), an SBS Entity would be required to verify whether a counterparty whose identity is known to the SBS entity prior to execution of the transaction is an ECP or a special entity, subject to an exception from verification as an ECP for transactions executed on an NSE or SBSEF. We recommend that the requirement to verify counterparty status as a special entity also include an exception for NSE- or SBSEF-traded SBS, consistent with the exceptions proposed in PR 15Fh-4(b)(3) and 15Fh-5(c).

Additionally, as a technical matter, certain electronic execution functionalities may reveal the identity of the prospective parties just prior to execution, but within a time frame within which an exchange of representations or other means for verification of status is not logistically feasible. We respectfully request that the Commissions narrow PR 15Fh-3(a) so that it does not cover such transactions where the SBS Entity must execute the transaction within a limited time frame after learning the counterparty's identity or, in the alternative, require that SBSEFs implement processes designed to permit verification of status in accordance with PR 15Fh-3(a).

We also note that the Commission has requested comment as to whether it should establish specific documentation requirements regarding counterparty status. In our view, any such specific documentation requirements, whether in the context of counterparty status or otherwise, would be inappropriate and contrary to the purposes and objectives of the SBS markets, which has been to provide for flexible risk management and investment decisions through private contractual negotiation.

IV. Business Conduct Requirements: Disclosure

A. Material Risks and Characteristics

Under PR 15Fh-3(b)(1), before entering into an SBS, an SBS Entity would be required to disclose to a counterparty, other than a Swap/SBS Entity, information concerning the SBS in a manner "reasonably designed to allow the counterparty to assess the material risks and characteristics of the particular" SBS. The factors to be identified include the material factors that influence the day-to-day changes in valuation, the factors or events that might lead to significant losses, the sensitivities of the SBS to those factors and conditions, and the approximate magnitude of the gains or losses the SBS will experience under specified circumstances.

The Commission notes in the Proposing Release that it has interpreted these disclosure provisions to require disclosure only about the material risks and characteristics of the SBS itself and not of the underlying reference security or index, and only in relation to the SBS itself (and not in relation to any particular counterparty).[24] We ask the Commission to make this clear in the text of the actual rule in order to eliminate any uncertainty about the required

[24] Proposing Release at 42407, fn. 76.

disclosure. In addition, in response to the various questions posed by the Commission in the Proposing Release, we suggest the following clarifications be made to the disclosure requirements:

- **Use of Master Agreement and Trade Acknowledgement**: The requirements for disclosure of material characteristics of an SBS should be satisfied by the execution of a master agreement and the provision of a trade acknowledgement (or draft trade acknowledgement). These two documents include all of the terms agreed to by the parties that could affect the economic and other risks of the transaction and, as such, satisfy the disclosure requirements under the Proposed Rules and Dodd-Frank.

- **Standardized Disclosure**: If the Commission requires disclosure beyond the master agreement and trade acknowledgment, we would urge it to permit the use of standardized disclosure and to exclude from such requirements counterparties that are regulated entities such as banks, broker-dealers, and investment advisers. As the Commission has itself acknowledged, general types of risks, including credit risk, settlement risk, market risk, liquidity risk, operational risk, and legal risk are commonly associated with SBS. Therefore, the Commission should permit the use of standardized disclosure to discharge the disclosure obligations described above. Such standardized disclosure could be developed, maintained and supplemented by industry trade groups or self-regulatory organizations ("SROs").

- **Timing of Disclosure**: The Commission should not, in our view, dictate the timing of required disclosures either by prohibiting advance disclosures in standardized documents forming part of a master agreement or by requiring disclosure immediately prior to the execution of a trade where such disclosure obligations would interfere with the counterparty's desired execution timing. Where an SBS is executed on an SBSEF/NSE or where the identity of the counterparty is known only immediately prior to or after execution, advance disclosure requirements would not be feasible and would effectively delay and disrupt such transactions, without any attendant benefit to the counterparty. In particular, the Proposed Rule mandates disclosure in a manner "reasonably designed to allow the counterparty to assess" material risks and characteristics. A requirement for advance disclosures that meet this standard in circumstances where the identity of the prospective parties is revealed just prior to execution would be impossible for the SBS Entity to satisfy unless (1) all possible participants in the system are known to the SBS Entity and (2) the requirement can be satisfied with a combination of highly standardized disclosures delivered in advance of participation in the system plus a statement of the price of the trade immediately prior to trading. If any other approach is adopted, it is difficult to see how compliance would be possible because there would be no time for the counterparty to evaluate the relevant disclosure and, as such, really no way to comply with an obligation to deliver disclosures that permit meaningful counterparty evaluation.

- **No Disclosure of Anticipated Profits**: The Commission should not require an SBS Entity to disclose its anticipated profit for the SBS. Such a requirement was expressly

rejected by Congress when it enacted Dodd-Frank.[25] Moreover, the focus on an SBS Entity's profits is, in our view, fundamentally misplaced.[26] The best protection for a counterparty is measured not by the profit of the SBS Entity but rather by the counterparty's (or its advisor's) review and selection of the best available pricing.

- **No Requirement for Scenario Analysis**: The Commission should not require scenario analyses to be provided. In this regard, we ask that the Commission delete the requirement that risk disclosures set forth the approximate magnitude of the gains or losses the SBS will experience under specified circumstances, as it is unclear to us how this requirement is distinguishable from a requirement to provide a scenario analysis. As we discussed extensively in our comments to the CFTC Proposal, the provision of scenario analysis is not required by Dodd-Frank. While we support the disclosure of scenario analysis for specified SBS as a best practice in appropriate circumstances, we do not believe that the Commission should impose such a requirement universally and as a matter of federal regulation.

  The term "scenario analysis" encompasses many different types of analyses, including the modeling of a broad range of political, economic, and other events beyond changes in the levels of underlying market factors, and involves subjective judgments in either case about the factors or scenarios to be modeled. As a result, any requirement that SBS Entities provide such information would raise many issues when considered in combination with the DOL Regulations,[27] investment adviser provisions, Dodd-Frank's municipal advisor provisions, and other aspects of the Proposed Rules. For example, providing a scenario analysis could cause a SBS Entity to be treated as a fiduciary under the DOL Regulations or become subject to certain provisions of the Advisers Act or Dodd-Frank's municipal advisor provisions because a scenario analysis is clearly intended to be used in connection with (and perhaps may be used as a primary basis for) an investment decision. Similarly, disclosure of a scenario

---

[25] The text used as the base for the House-Senate conference on H.R. 4173 included a requirement that Swap Entities disclose "the source and amount of any fees or other material remuneration that the swap dealer or major swap participant would directly or indirectly expect to receive in connection with the swap," but that provision was struck during the conference process.

[26] Other considerations aside, an SBS Entity's estimate of anticipated profit will frequently depend on assumptions about future market factors, such as the availability and cost of stock borrow and financing.

[27] The current regulation, Definition of "Fiduciary," 29 CFR § 2510.3-21(c) (1975), has been in force since 1975 (the "Current DOL Regulation"). If adopted, the proposed regulation, Definition of the Term "Fiduciary," 75 Fed Reg. 65263 (Oct. 22, 2010) (the "Proposed DOL Regulation" and, together with the Current DOL Regulation, the "DOL Regulations") would become effective 180 days after the publication of the final regulation in the Federal Register. Under the Proposed DOL Regulation, an investment adviser (as defined in Section 202(a)(11) of the Advisers Act), whether or not registered, would be a *per se* fiduciary. All other service providers would be fiduciaries if they render any advice that is individualized and that may be used in connection with the investment decision of an employee benefit plan subject to ERISA, with a limited exception for certain transactions in which the recipient reasonably knows the advice is not impartial investment advice.

analysis could be viewed as a "recommendation" to the counterparty (regarding the range of market moves it should consider likely or worth considering), which, under the Proposed Rules as drafted, could trigger the Proposed Rules' heightened suitability and potentially the "best interests" requirements.[28]

- **Applicable Provisions if Scenario Analysis Is Required**: If a scenario analysis is required, it should only be at the request of the counterparty and only with respect to scenarios based on parameters selected by the counterparty. That is, it should be made clear that the "specified circumstances" referenced in the rule are circumstances specified by the counterparty and that delivery by the SBS Entity of scenario analyses that address the circumstances specified by the counterparty satisfies the SBS Entity's obligations under the rule.

- **No Requirement to Disclose Absence of Certain Terms**: The Commission should not require an SBS Entity to disclose the absence of certain material provisions typically contained in master agreements for SBS transactions. Master agreements may differ in many respects as a result of the particular characteristics of the transaction, the relationship between the SBS Entity and the counterparty, or the circumstances of the counterparty. What is "typical" is not clear. Additionally, contractual negotiations invariably involve subjective judgments in which parties make concessions on certain points in exchange for counterparty concessions on other points. We believe that it would not be appropriate for the Commission to effectively mandate a most-favored-nations disclosure obligation across all counterparties.

- **Clearing Disclosure**: While we generally support the Commission's proposal regarding disclosure relating to a counterparty's right to choose whether and where to clear an SBS, we ask the Commission to confirm that a counterparty's election to have an SBS cleared and its choice of the clearing agency could affect the price of the SBS so long as this is disclosed to the counterparty at the time of the other disclosures regarding clearing. We believe that the ability to use standardized disclosures is equally important in this context. Accordingly, we request that the Commission clarify that a single disclosure of the proposed clearing arrangement in a master agreement plus a statement that the counterparty can actively request a change to the disclosed arrangement with respect to any given trade would be sufficient to satisfy this requirement.

---

[28] Consistent with this discussion, we recommend that the Commission clarify that its reference to disclosure regarding the "sensitivity" of an SBS to market factors or conditions is intended to mean the directional sensitivity of the SBS to market factors or conditions expressly specified in the SBS and any contractual leverage features, and is not intended to require sensitivity projections or disclosure regarding the sensitivity of the SBS's value to market factors other than those underlying the relevant SBS.

B. *Daily Marks*

Under PR 15Fh–3(c)(2), an SBS Entity would be required to provide a mid-market value or model-based valuation for uncleared SBS, similar to a requirement in the CFTC Proposal. Specifically, an SBS Entity would be required to disclose the midpoint between the bid and offer prices for a particular uncleared SBS, or the calculated equivalent thereof, as of the close of business unless the parties agree to another point in time in writing. The SBS Entity would also be required to disclose the data sources and describe the methodology and assumptions used to prepare the daily mark. According to the Commission, the provision of a daily mark along with the data sources, assumptions, and methodology used in its preparation, should provide a useful reference point for the counterparty.[29]

We agree generally with the Commission that disclosure of the daily mark for uncleared swaps should perform a function similar to that of a clearing agency's daily settlement price and that it is not intended to represent a fair value, or other value at which the SBS might be executed or traded. Inevitably, however, particularly in circumstances where a midmarket level is not observable, subjective judgments and modeling will be involved in coming up with a level. Consequently, there remains an irreducible level of ambiguity as to whether the disclosing SBS Entity may be regarded as expressing a view as to the value of the transaction, thereby raising questions as to whether it is providing some form of advice, and whether that activity raises potential advisory or fiduciary responsibilities under applicable common law, state law or federal law.

We urge the Commission to clarify that the proposed daily mark disclosure is not intended to represent any form of valuation or advice for any purpose. Moreover, where contracting parties have agreed upon the basis for margining uncleared swaps between them, the SBS Entity should be permitted to satisfy its disclosure obligation by providing the daily mark that it has used to make the related margin computation. At the very least, before imposing an obligation to provide daily marks other than those agreed upon for collateral purposes and other than those for which midmarket quotations are observable, the Commission should carefully review and consider the cost of such a requirement. Consistent with our recommendation in Part I.A above, we also request that the Commission permit sophisticated counterparties to opt out of the requirement to receive a daily mark.

Additionally, and more specifically, as we noted in our comment letter to the CFTC Proposal, this requirement would raise concerns in the case of transactions with ERISA plans to the extent such valuations could be considered "advice" under the Proposed DOL Regulation. Since the Proposed DOL Regulation provides that appraisals concerning the value of securities or other property are fiduciary advice, the Commission and DOL should coordinate their regulations so as to expressly exclude the provision of a daily mark from the definition of "an appraisal." Otherwise, the provision of daily marks could cause the SBS Entity providing the

[29] Proposing Release at 42449.

valuation to be deemed an ERISA fiduciary and the SBS to become prohibited under ERISA. Although the Commission notes in the Proposing Release that the DOL has indicated in a letter to the CFTC that "a swap dealer or major swap participant that is acting as a plan's counterparty in an arm's length bilateral transaction with a plan represented by a knowledgeable independent fiduciary would not fail to meet the terms of the counterparty exception [to the proposed revised definition of ERISA fiduciary] solely because it complied with the business conduct standards set forth in the CFTC's proposed regulation,"[30] such correspondence would not provide sufficient comfort to market participants engaged in transactions with special entities in light of the specific provisions of the proposed regulations.

We also respectfully recommend that the Commission confirm that providing a daily mark will not subject an SBS Entity to municipal advisor registration and that providing a daily mark would not constitute advice "as to the value of" an SBS and so should not subject an SBS Entity to investment adviser registration.[31] To varying degrees, registration as a municipal advisor or investment adviser would subject an SBS Entity to fiduciary requirements, which would be inconsistent with congressional intent, as implemented by the Commission's proposed definition for when an SBSD will be regarded to be acting as an advisor, that SBS Entities only become subject to such requirements in narrow circumstances.

IV. Business Conduct Requirements: Recommendations of SBS or Trading Strategies

Under the Proposed Rules, a "recommendation" made to a counterparty that is not a special entity would be required to be "suitable" for that counterparty.

As we discussed in our comments to the CFTC Proposal, this requirement is not mandated by Dodd-Frank and we do not believe that it is necessary or appropriate for the SBS market. Given the prevalence of institutional suitability requirements in the U.S. securities markets and non-U.S. financial markets, Congress clearly could have determined to impose an institutional suitability requirement on SBS Entities. However, Congress did not do so except in the limited case of special entities, where Congress mandated that an SBS Entity must have a reasonable basis to believe that a Special Entity has a qualified independent representative.[32] For

---

[30] Letter from Phyllis C. Borzi, Assistant Secretary, Employee Benefits Security Administration, Department of Labor, to Gary Gensler, Chairman, CFTC (April 28, 2011).

[31] See Advisers Act Section 202(a)(11) (defining the term "investment adviser" as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the *value of securities* . . . .") (emphasis added).

[32] Exchange Act Section 15F(h)(5)(A). We also note that Congress did, where it believed necessary, borrow other standards from SRO rules when enacting Dodd-Frank, such as in the case of the requirement for SBS Entities to communicate in a fair and balanced manner based on principles of fair dealing and good faith. See Exchange Act Section 15F(h)(3)(C).

counterparties more generally, Congress determined only to impose a requirement that SBS Entities verify that each counterparty meets the criteria for an ECP.[33]

If the Commission believes that implementing an institutional suitability requirement is nonetheless appropriate, we strongly urge the Commission to do so through a requirement to adopt and enforce policies and procedures reasonably designed to assess the suitability of recommendations made to counterparties other than special entities. The substance of the Commission's proposed suitability rule could then be incorporated as guidance establishing a safe harbor for whether an SBSD's suitability policies are reasonable. In addition, the Commission should clarify that an SBSD that complies with suitability requirements of another qualifying regulator will also be deemed to have adopted and enforced reasonable suitability policies. This clarification is important because, as the Commission notes,[34] many other regulators impose suitability requirements, which might (in at least technical ways) conflict with the specific suitability rules proposed by the Commission.

In addition, we note that many counterparties will have no need for institutional suitability analysis from their SBS Entity counterparty and will find such a requirement to be intrusive and burdensome. Accordingly, consistent with our more general recommendation above regarding opt-out rights, we recommend that sophisticated counterparties be permitted to opt out of suitability protection. Such an opt-out right is important to assuring that any final rule does not impose blanket requirements for which the costs will likely outweigh the benefits in the case of sophisticated counterparties.

V. Business Conduct Requirements: Know Your Counterparty

Although not mandated by Dodd-Frank, PR 15Fh-3(e) would require an SBSD to have policies and procedures reasonably designed to obtain and retain a record of the essential facts concerning a known counterparty that are necessary to (i) comply with applicable laws, regulations and rules, and (ii) effectuate the SBSD's credit and operational risk management policies in connection with transactions entered into with such counterparty. Additionally, "essential facts" include (i) information regarding the authority of any person acting for such counterparty, and (ii) if the counterparty is a Special Entity, such background information regarding the independent representative as the SBSD reasonably deems appropriate.

We support the Commission's implementation of this requirement through policies and procedures and its definition of "essential facts" by reference to clear and objective information that can be readily obtained through counterparty representations. We ask, however, that the Commission confirm that because this requirement applies to *known* counterparties, it would not apply if an SBSD transacting on an SBSEF or other electronic platform learns of the

---

[33] See Exchange Act Section 15F(h)(3)(A).

[34] Proposing Release at 42415. See also CFTC Proposal at 80647 (also discussing suitability requirements under the EU's Markets in Financial Instruments Directive and National Futures Association rules).

identity of the counterparty only just prior to execution but must execute the transaction within a limited time frame after learning the counterparty's identity.

VI. Business Conduct Requirements: Supervision

PR 15Fh-3(i) would require SBS Entities to establish, maintain and enforce a system of diligent supervision, including written policies and procedures reasonably designed to comply with the duties set forth in Section 15F(j) of the Exchange Act. Section 15F(j) of the Exchange Act includes, among other requirements, obligations concerning: (i) monitoring of trading to prevent violations of applicable position limits; (ii) establishing sound and professional risk management systems; (iii) disclosing to regulators information concerning trading in SBS; (iv) establishing and enforcing internal systems and procedures to obtain and produce necessary information; (v) mitigating conflicts of interest, and (vi) preventing antitrust violations.

We support the Commission's proposal to implement these rules through a flexible policies and procedures requirement that does not mandate detailed specified elements for inclusion in the relevant policies and procedures. We believe this approach avoids many of the issues presented by the CFTC's proposals for addressing these statutory duties because it would allow SBS Entities to determine how best to comply with Dodd-Frank's requirements given their particular organizational structures.[35] In this regard, we respectfully request that the Commission confirm that, when an SBS Entity is already subject to and complies with comparable requirements of another qualifying regulator (such as risk management standards imposed by a prudential regulator), that SBS Entity's policies and procedures will be deemed to have been reasonably designed for purposes of the Commission's business conduct requirements.

In addition, PR 15Fh-3(i)(3) contains several important clarifications regarding the scope of supervisory obligations under the Proposed Rules that are generally consistent with the obligations established under analogous regimes for broker-dealers and other Commission registrants. In particular, the Commission has clarified that an SBS Entity or one of its associated persons will not be deemed to have failed to diligently supervise any other person if (a) such other person was not "subject to his or her supervision" or (b) if (i) the SBS Entity has established and maintained written policies and procedures, and a system for applying those policies and procedures, that would reasonably be expected to prevent, to the extent practicable, any violation of the federal securities laws and the rules thereunder related to SBSs and (ii) the SBS Entity or its associated person has reasonably discharged the duties and obligations incumbent on it by reason of such procedures and system without a reasonable basis to believe that such procedures and system were not being followed.[36]

---

[35] See CFTC Proposed Rules, Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71397 (Nov. 23, 2010); Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71391 (Nov. 23, 2010).

[36] Cf. Section 15(b)(4)(E) of the Exchange Act and Section 203(e)(6) of the Advisers Act.

In this regard, we request that the Commission confirm that a person committing a violation will not be viewed as being "subject to [the] supervision" of another person unless the putative supervisor knew or should have known that he or she had the authority and responsibility to exercise control over the other person that could have prevented the violation.[37] This clarification is essential to ensuring accountability within an effective supervisory framework. In the compliance context, this approach would be consistent with the Commission's further clarification that a CCO does not ordinarily have supervisory responsibilities outside the compliance department.[38] We believe this is a necessary delineation of responsibilities in order for legal and compliance personnel to perform their role as independent advisors to business line supervisors effectively.[39]

VII. Special Requirements for SBS Entities Acting as Counterparties to Special Entities

PR 15F(h)(5) would require that SBS Entities that offer to or enter into an SBS with a special entity have a "reasonable basis" to believe that the special entity has a "qualified independent representative." This provision also requires that the SBS Entity disclose in writing the capacity in which it is acting (*e.g.*, as principal) before initiating a transaction with a special entity. We ask the Commission to clarify three points with respect to these rules.

- **Definition of "Offer"**: In response to the Commission's request for suggested clarifications to the definition of "offer," we recommend that the Commission, consistent with its approach in related contexts, exclude preliminary negotiations[40] and instead regard a communication of SBS trading interest as an "offer" only when, based on the relevant facts or circumstances, it is "actionable" or "firm."[41]

- **Disclosure of Capacity**: Under the Proposed Rules, if an SBS Entity engages in business, or has engaged in business within the last 12 months, with its counterparty in more than one capacity, it would be required to disclose the material differences

---

[37] See In the Matter of Arthur James Huff, Exchange Act Release No. 29017 (Mar. 28, 1991) (Lochner, Schapiro, Commissioners, concurring); see also In the Matter of Patricia Ann Bellows, Exchange Act Release No. 40411 (July 23, 1998).

[38] Proposing Release at 42436.

[39] See generally Securities Industry Association Compliance &Legal Division, White Paper on the Role of Compliance (Oct. 2005); Brief of the Securities Industry and Financial Markets Association et al. as Amici Curiae Supporting Appellee-Cross Appellant Theodore W. Urban, In the Matter of Theodore W. Urban, Admin. Proc. No. 3-13655 (Nov. 22, 2010).

[40] See, e.g., Section 2(a)(3) of the Securities Act of 1933 (definition of "offer").

[41] See, e.g., Release No. 34-60997, 74 Fed. Reg. 61208, 61210-13 (Nov. 23, 2009) (discussion of actionable indications of interest). See also Release No. 34-40760, 63 Fed. Reg. 70884, 70850 (Dec. 22, 2008) (distinguishing between "firm" and "non-firm" indications of interest).

between such capacities in connection with the SBS and any other financial transaction or service involving the counterparty. We believe that it would be impossible for an SBS Entity to ascertain and disclose every other relationship it may have with its counterparties. For example, if the SBS Entity sells fixed income instruments to a plan managed by manager A and does an SBS with the same plan managed by manager B, there is no reason to require any disclosure of the fixed income sales arrangement. Large financial institutions have many points of contact with counterparties, both directly and through their intermediaries, and it would not be feasible or useful to require that such information be systematically collected and disclosed.[42] In this connection, we note that the Proposing Release does not include a description or analysis of the costs that would be associated with such a disclosure requirement.

Accordingly, we request that the Commission narrow this requirement to cover disclosure of the material differences between the capacities in which the SBS Entity itself (and not any of its affiliates or other associated persons) is acting in connection with the relevant SBS transaction. If the Commission were to require disclosure regarding the capacities in which the SBS Entity has acted with respect to the counterparty other than in connection with the relevant SBS transaction, the SBS Entity should be permitted to satisfy that requirement with a generic disclosure of the general types of capacities in which it may act or have acted with respect to the counterparty and a statement distinguishing those capacities from the capacity in which the SBS Entity is acting with respect to the present SBS.

- **Safe Harbor for Certain Regulated Representatives**: We ask the Commission to establish a safe harbor that would permit an SBS Entity to conclude that the special entity's representative is "qualified" and "independent" if the representative is a sophisticated, professional advisor such as a bank, SEC-registered investment adviser, insurance company or other qualifying QPAM or INHAM for special entities subject to ERISA.[43] With respect to special entities, for example, the DOL has determined that the qualification and independence tests in the QPAM and INHAM exemptions are sufficient to ensure that the plan is adequately represented to engage in a wide variety of otherwise prohibited transactions with financial institutions, including swaps/SBS. Similarly, we request that the Commission establish a safe harbor that would permit an SBS Entity to conclude that the special entity's representative is "qualified" (but not necessarily "independent") if the representative is a registered municipal advisor, an SEC-registered investment adviser that provides investment

[42] In this regard, we note that, if an SBS Entity for this purpose includes "associated persons," the disclosure would be even more cumbersome and immaterial.

[43] See DOL Class Prohibited Transaction Exemption 84-14, as amended; DOL Class Prohibited Transaction Exemption 96-23, as amended.

advice with respect to SBS (as disclosed in Part 2 of its Form ADV) or a foreign entity having an equivalent status abroad.

VIII. Business Conduct Requirements: Exceptions for Exchange-Executed SBS Transactions with Special Entities

For SBS Entities acting as counterparties or advisors to special entities, the Proposed Rules would provide exceptions from requirements for exchange-executed SBS. However, the proposed exception for these SBS would only apply to transactions to the extent (i) they are executed on a registered SBSEF or NSE; and (ii) the SBS Entity does not know the identity of the counterparty, at any time up to and including execution of the transaction. While we recognize that this standard is drawn from Dodd-Frank, we believe that the statutory language was intended to be broader than the Commission has interpreted it. Section 15F(h)(7) states that "[t]his ***subsection*** shall not apply with respect to a transaction that is (A) initiated by a special entity on an exchange or security-based swap execution facility; and (B) one in which the security-based swap dealer or major security-based swap participant does not know the identity of the counterparty to the transaction" (emphasis added). Accordingly, we believe it is clear that the exception is intended to apply to all the external business conduct requirements promulgated under subsection (h), and not merely those relating to SBSDs acting as advisors to special entities and those relating to SBS Entities acting as counterparties to special entities.

We are additionally concerned that the limited scope of this exception would, if adopted, be problematic for transactions executed using request-for-quote or other similar forms of execution (including on SBSEFs and single dealer or broker screens or other non-SBSEF forms of electronic execution) where the counterparty's identity is known before execution, but the time between disclosure of counterparty identity and execution is too limited a timeframe within which to perform transaction specific pre-execution obligations. We therefore recommend that the Commission expand the scope of the exception to include these circumstances, which are equivalent in practice to the other circumstances within the proposed exception and necessary, as a practical matter, to effectuate congressional intent.

IX. Political Contributions

Although not mandated by Dodd-Frank, PR 15Fh-6 would impose a ban on SBS activity with a municipal entity for two years following any contribution to an official of such municipal entity made by the SBSD or any "covered associate" of the SBSD. Because the Commission's proposal is nearly identical to the CFTC Proposal, our comments generally track those we made in response to the CFTC Proposal.

At the outset, we note that Dodd-Frank did not mandate any restrictions on political contributions by SBSDs, and so it is not clear to us that the Commission needs to impose such a requirement on a discretionary basis. In this connection, we note that regulations promulgated by the MSRB on political contributions made in connection with municipal

securities business[44] will already cover most SBSDs doing business with municipal entities, and so there may not be much marginal benefit to imposing additional restrictions on SBSDs generally. If, however, the Commission believes it necessary to impose a ban on SBS activity as provided in the Proposed Rules, we suggest that the Proposed Rules governing the political contributions of SBSDs parallel in certain respects, as described below, those MSRB regulations.

First, we ask the Commission to consider replacing as the triggering occasion for the application of the rule an "offer to enter into or enter into a security-based swap or a trading strategy involving a security-based swap" with a term—"engage in municipal security-based swap business"—more akin to the terms used in the relevant MSRB Rules, "engage in municipal securities business" and "engage in municipal advisory business." Likewise, we recommend that "municipal security-based swap business" be defined to mean "the execution of a security-based swap with a municipal entity."

Furthermore, we urge the Commission to narrow the definition of "solicit" as applied to any "covered associate" employee of an SBSD. As currently drafted, a solicitation would include any "direct or indirect communication by any person with a municipal entity for the purpose of obtaining or retaining an engagement related to a security-based swap." Since employees of a financial institution often communicate with a municipal entity about bond, SBS and reinvestment structures simultaneously, the term "solicit" could implicate communication by employees of a financial institution that do not have a role in the SBS business and who are already regulated by the MSRB or the SEC. We would recommend that the Commission clarify the definition of "solicit" to include only "any direct communication by any person with a municipal entity for the purpose of obtaining or retaining municipal security-based swap business," and to exclude any communication by any person with a municipal entity for the sole purpose of obtaining or retaining any other type of business covered under pay-to-play restrictions, such as municipal securities business or municipal advisory business. Such communications would already trigger pay-to-play restrictions under other regulations, and a broader definition of "solicitation" could result in a scenario where an individual is covered under duplicate or triplicate pay-to-play laws for the mere act of discussing just one type of covered activity. This would result in overlapping regulations that would provide no additional benefit in terms of curbing pay-to-play activities, but would create substantial additional recordkeeping and administrative burdens on the SBSD.

---

[44] MSRB Rule G-37(b) provides that "no broker, dealer or municipal securities dealer shall engage in municipal securities business with an issuer within two years after any contribution to an official of such issuer." See MSRB Rule G-37 Political Contributions and Prohibitions on Municipal Securities Business. The Proposed Rule does not, for example, include the analogous provision of MSRB Rule G-37 limiting the scope of the rule to municipal financial professionals "primarily engaged in municipal financial representative activities . . . ." See also MSRB Proposed Rule G-42 Political Contributions and Prohibitions on Municipal Advisory Activities. Both "municipal securities business" and "municipal advisory business" are terms defined in the relevant rule. See MSRB Rule G-37 (g)(vii) and MSRB Proposed Rule G-42 (g)(vii), as applicable; see also Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, SIMFA, to Ronald W. Smith, Corporate Secretary, MSRB (Feb. 25, 2011) (commenting on Proposed Rule G-42); Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, SIMFA, to Elizabeth M. Murphy, Secretary, SEC (Feb. 25, 2011) (same).

In addition, we suggest that the Commission modify proposed Rule PR 15Fh-6(e)(1) to allow for up to three exemptions for inadvertent contributions, depending on the number of SBSD employees. This would parallel the provisions in SEC Rule 206(4)-5, relating to contributions from certain covered associates of investment advisers.

Finally, we urge the Commission to include a provision, parallel to the relevant MSRB rules, which specifies an operative date for the rule, such that it only applies to contributions made on or after its effective date.[45] This is necessary to clarify that the rule would not unintentionally ban SBS activity as a result of contributions made during the pre-effectiveness period when many SBSDs did not, nor reasonably could have been expected to, have policies and procedures in place for pre-clearance of contributions by their employees.

X. Designation of Chief Compliance Officer for SBS Entities

Section 15F(k) of the Exchange Act requires an SBS Entity to designate a CCO and imposes certain duties and responsibilities on that CCO. PR 15Fk-1 would codify the provisions of Exchange Act Section 15F(k) with some modifications based on the current compliance obligations applicable to CCOs of other Commission-regulated entities.

The Commission also makes certain important clarifications regarding the role and responsibilities of the CCO, which we strongly support as necessary to avoid the adverse consequences that would result from the ways in which the CFTC's CCO proposal would, if adopted as proposed, depart from longstanding principles governing the compliance frameworks for regulated financial services companies. In particular, the Commission has clarified that (i) the CCO's duty under Dodd-Frank to "ensure compliance" is a duty to establish, maintain and review policies and procedures reasonably designed to achieve compliance,[46] (ii) the CCO's role with respect to resolution and mitigation of conflicts of interest would include the recommendation of one or more actions, and appropriate escalation and reporting, rather than decisions relating to final resolution[47] and (iii) the title of CCO does not, in and of itself, carry supervisory responsibilities outside of the compliance department.[48]

These clarifications are, in our view, fully consistent with Dodd-Frank and address many of the comments submitted with respect to the CFTC's CCO proposal (including the

---

[45] See MSRB Rule G-37(h) and MSRB PR G-42(h).

[46] By way of clarification, we recommend that the Commission change the word "ensure" in PR 15Fk-1(b)(5) to "achieve," consistent with the discussion in the preamble of the Proposing Release.

[47] We note that the Proposed Rules do not define the types of "conflicts of interest" that are relevant for purposes of the duty imposed upon CCOs under PR 15Fk-1(a)(3). In this regard, we ask that the Commission confirm that the relevant conflicts of interest would be those which are reasonably identified by the SBS Entity's policies and procedures, taking into consideration the nature of the SBS Entity's business.

[48] Proposing Release at 42436.

comments of the National Futures Association).[49] Moreover, these clarifications are necessary to preserve the CCO's role as a trusted but independent advisor to senior business personnel. They also help avoid subjecting CCOs to liability as supervisors unnecessarily, which would tend to chill CCOs' involvement in business activities and reduce the sense of individual responsibility among those business personnel with actual supervisory authority and control.

In addition, however, we recommend that the Commission make certain clarifications and modifications to PR 15Fk-1, as described immediately below:

- **"Administration" of Policies and Procedures:** PR 15Fk-1(b)(4) includes language, drawn from Dodd-Frank, stating that the CCO shall "[b]e responsible for administering each policy and procedure that is required to be established pursuant to Section 15F of the Act and the rules and regulations thereunder." In practice, however, the scope of policies and procedures that a CCO is directly responsible for "administering" is typically quite narrow (e.g., anti-money laundering policies), since administration of business-related policies and procedures is the responsibility of a business supervisor (e.g., suitability policies) and, as the Commission has noted, CCOs generally do not have supervisory responsibilities outside of the compliance department. Accordingly, we ask that the Commission clarify this requirement by modifying it to specify that the CCO is responsible for "coordinating supervisors' administration of" the relevant policies and procedures.

- **Compensation and Removal of CCO:** The Proposed Rules would require that the compensation and removal of an SBS Entity's CCO be approved by a majority of the SBS Entity's board of directors. This requirement is not mandated by Dodd-Frank and stands in contrast to requirements applicable to similarly situated employees for whom such approval is not required in large global organizations. This proposal attempts to address the issue of the independence of risk control professionals, an issue that has already been addressed in detail by numerous federal regulators, including the Commission.[50] Given that this issue has already been addressed in those other

[49] See Letter from Thomas Sexton, Senior Vice President and General Counsel, National Futures Association, to David A. Stawick, Secretary, the CFTC (Jan. 18, 2011).

[50] See The June 2010 Interagency Guidance on Sound Incentive Compensation Policies (promulgated by the OCC, Federal Reserve, FDIC and OTS) which stated that the compensation for control personnel "should not be based substantially on the financial performance of the business unit that they review." Furthermore, the rules jointly proposed by the OCC, Federal Reserve, FDIC, OTS, NCUA, SEC and FHFA under Section 956 of Dodd-Frank state that risk management, oversight and internal control personnel must "have an appropriate role" in designing incentive compensation arrangements and that covered financial institutions should have "appropriate controls" to maintain the integrity of the risk management and other functions. Notably, the jointly proposed rules do not require or even contemplate board approval of compensation paid to control personnel, even though board approval is specifically required for incentive compensation arrangements paid to certain executive officers and material risk-takers. Clearly, if the regulators felt that board approval of control function compensation was appropriate, they would have included such a requirement in the Section 956 proposed rules.

contexts, and in a manner that does not mandate board approval, we believe this requirement is unnecessary and would impose additional organizational inefficiencies and other unwarranted costs while providing minimal, if any, incremental benefits. Accordingly, we request that the Commission delete this requirement.

- **Reporting to Board of Directors or Senior Officer**: The Proposed Rules would require the CCO to report directly to the board of directors, a body performing a function similar to the board, or to the senior officer of the SBS Entity. The Commission defines the "senior officer" as the chief executive officer ("CEO") or an equivalent officer. This definition is problematic for large institutions for which U.S. SBS dealing is only one business line among many but whose SBS Entity CCO would nevertheless be required to report directly to the board of directors or the CEO of the institution. Depending on the institution, senior compliance personnel currently report to the CEO, the chief legal officer or general counsel, the global head of compliance, the chief risk officer, or other structures that are established taking into account the institution's particular business, regulatory status and other relevant considerations. Ensuring that the CCO's reporting lines remain separate from the business line of supervision is a reasonable approach to ensuring independence; however, an SBS Entity that is part of a larger integrated multi-service financial organization may well conclude that it is important to ensure that the senior management to whom the CCO reports is sufficiently familiar with the swap activities of the SBS Entity to effectively manage the compliance risks of the entity. In order to best achieve these objectives, we recommend that the Commission permit greater flexibility to SBS Entities in determining the most effective reporting framework in light of their individual structure and circumstances.

  At the most basic level, it is critical that the CCO be sufficiently independent of business line personnel and has sufficient authority to discharge his or her duties effectively.[51] No single organizational structure is suitable for the achievement of these objectives across every type of institution. Accordingly, we urge the Commission to define the term "senior officer" to include a more senior officer within the SBS Entity's compliance, risk, legal or other control function of the SBS Entity as the SBS Entity shall reasonably determine to be appropriate. The SBS Entity should be required to take into consideration the nature of its business, in ensuring sufficient independence of the CCO from business line supervision to permit the CCO to effectively oversee the compliance infrastructure at the SBS Entity and to escalate material compliance matters to the board of directors of the SBS Entity. In this regard, we note that, regardless of the individual to whom the CCO reports on a day-to-day basis, the CCO would still, under the Proposed Rules, conduct an annual compliance meeting with the SBS Entity's CEO and submit an annual compliance report to the SBS Entity's board of directors.

[51] See Federal Reserve Supervisor Letter 08-08 (Oct. 16, 2008) (discussing compliance oversight at large banking organizations).

- **Consolidated Annual Reporting:** PR 15k-1(c) could be interpreted to require the separate submission of an annual report for each SBS Entity within a consolidated financial institution, even where the CCO is the same for each, and where the SBS Entities are under common compliance management and oversight. It could also be interpreted to require that an SBS Entity that is also registered as a broker-dealer submit separate reports with respect to its SBS and its other securities activities, respectively. Given the integrated compliance management of many large financial institutions, we believe that permitting the consolidation of annual reporting requirements for SBS Entities under common control (including those that are also registered broker-dealers) would better achieve the objectives set forth in Dodd-Frank, by eliminating duplicative information and better enabling the Commission to evaluate the consolidated SBS Entities' compliance with Dodd-Frank.[52]

- **Contents of Annual Report:** PR 15Fk-1(c)(1)(i) would require the CCO's annual report to contain a "description of . . . [t]he compliance of" the SBS Entity, as distinct from a description of the SBS Entity's compliance policies and procedures, as proposed under PR 15Fk-1(c)(1)(ii). We ask the Commission to clarify that PR 15Fk-1(c)(1)(i)'s requirement would be satisfied by a description of the more detailed matters set forth in PR 15Fk-1(c)(2)(i), including a description of the SBS Entity's testing of its policies and procedures and any material compliance matters.[53] The report should not be meant to describe the SBS Entity's "compliance" in an absolute sense, a requirement so broad and so vague as to be incapable of being fulfilled in practice, particularly in the context of a document intended to be meaningful for a board of directors.[54] Since SBS Entities are already subject to self-reporting requirements under PR 15Fk-1(b)(6)(iv), we recommend that the report focus on a description of the SBS Entity's program for testing its policies and procedures, as well as the identification of open remediation matters at the time of the report that have resulted from such tests.

---

[52] For example, many of the policies and procedures issued by SBS Entities in a consolidated financial organization apply across the organization. Testing and review of compliance with these policies frequently occurs across legal entities. Submission of multiple annual reports would result in the duplication of information submitted to the Commission, increasing the burden on both the Commission and the SBS Entities to review and create this detail, without corresponding benefits in oversight.

[53] Existing FINRA Rule 3130 requires a member firm's chief executive officer (or equivalent) to certify to the processes the member firm has in place to establish maintain and review policies and procedures, modify such policies in light of changes and to test their effectiveness. "Enforcement" of an SBS Entity's policies and procedures is a broad concept, and is too vague to result in a meaningful report. Enforcement occurs on multiple levels—from a supervisor or control-side person at an SBS Entity instructing a businessperson to take a particular action in a particular fashion to the modification of controls as a result of a reportable incident.

[54] In addition, we note that PR 15Fk-1(c)(2)(iii) provides that compliance reports bound separately from financial statements shall be accorded confidential treatment. We ask that the Commission amend its Freedom of Information Act regulations in a manner consistent with this aspect of the Proposed Rules.

- **Certification of Annual Report:** The Proposed Rules would require the CCO to certify, under penalty of law, the completeness and accuracy of an annual report regarding compliance matters.[55] Although Dodd-Frank contains a detailed list of the CCO's responsibilities, including that he or she must prepare and sign the annual report, Dodd-Frank's separate requirement that the report contain a certification does not specify the CCO as the responsible individual. Consistent with established industry practices and analogous FINRA rules, as well as the Commission's guidance that the CCO does not necessarily have supervisory responsibilities, we recommend that the Commission specify the CEO or other relevant senior officer of the registrant, not the CCO, as responsible for the certification.[56]

- **Liability for Certification:** We note that the Commission has not proposed an interpretation of the phrase "under penalty of law" for purposes of the Proposed Rules. We are aware of no legislative history to suggest that this phrase was intended to impose penalties or standards on certifiers under Title VII additional to those that would ordinarily attach under applicable law.[57] In other contexts in which certifications "under penalty of law" have been required, the certifier is criminally liable only if he or she has been informed of inaccuracies and nonetheless certifies the accuracy of the document, and not merely because information in the document is inaccurate.[58] Accordingly, we ask the Commission to clarify that the liability standard for the certification is the same as that which applies to other documents filed with the Commission, including liability under Section 32 of the Exchange Act for willfully and knowingly making false or misleading material statements to the Commission.[59] Further, the certifier should, as in those other contexts, be responsible solely for stating that the documents were prepared under his or her direction or supervision in accordance with a system designed to ensure that qualified personnel would properly gather and evaluate the documents, and that based on his or her inquiry of those persons who were responsible for gathering the documents, to the best of his or her

---

[55] Proposing Release at 42437.

[56] Alternatively, if the Commission determines that the CCO must make the certification, we request that the CEO also be required to do so.

[57] In this regard, as we noted in our comments on the CFTC's CCO proposal, it is notable that Title VII of Dodd-Frank did not, during the legislative process, receive any referrals to the Judiciary Committees, which ordinarily would be required for any legislation that imposed additional criminal liability.

[58] See United States v. Hopkins, 53 F.3d 533, 542 (2d Cir. 1995) (affirming conviction where certifier was presented with information that reports were false).

[59] See, e.g., Form ATS, Form MSD, Form TA-1 and Forms 3, 4 and 5, which include language on the signature page that "intentional misstatements or omission of fact constitute federal criminal violations" under 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

knowledge, the documents were accurate in all material respects.[60] Without these clarifications, the Associations are concerned that it will be extremely difficult for SBS Entities to hire qualified employees as their CEO or CCO or otherwise establish an effective compliance and supervisory program. We also do not believe that subjecting a certifier to unduly broad liability, for example, where there has been no malfeasance by the certifier, would further, in any meaningful way, any public policy objective.

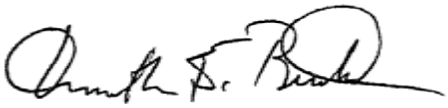
* * *

The Associations appreciate the opportunity to comment on the Proposed Rules. We would be pleased to meet with the Commission or its staff to discuss the contents within this letter and Dodd-Frank more generally. If you have any questions, please do not hesitate to contact the undersigned or our staff.

Respectfully submitted,

John M. Damgard
President
FIA

Robert Pickel
Executive Vice Chairman
ISDA



Kenneth E. Bentsen, Jr.
Executive Vice President
Public Policy and Advocacy
SIFMA

[60] See United States v. Robison, 505 F.3d 1208, 1227 (11th Cir. 2007).

cc: Honorable Mary L. Schapiro, Chairman
Honorable Kathleen L. Casey, Commissioner
Honorable Elisse B. Walter, Commissioner
Honorable Luis A. Aguilar, Commissioner
Honorable Troy A. Paredes, Commissioner
Securities and Exchange Commission

Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Commodity Futures Trading Commission

Phyllis C. Borzi, Assistant Secretary, Employee Benefit Security Administration
Department of Labor

Lynette Hotchkiss, Executive Director
Municipal Securities Rulemaking Board

Appendix: The Associations

The **Futures Industry Association** is the leading trade organization for the futures, options and OTC cleared derivatives markets. It is the only association representative of all organizations that have an interest in the listed derivatives markets. Its membership includes the world's largest derivatives clearing firms as well as leading derivatives exchanges from more than 20 countries. As the principal members of the derivatives clearinghouses, our member firms play a critical role in the reduction of systemic risk in the financial markets. They provide the majority of the funds that support these clearinghouses and commit a substantial amount of their own capital to guarantee customer transactions. FIA's core constituency consists of futures commission merchants, and the primary focus of the association is the global use of exchanges, trading systems and clearinghouses for derivatives transactions. FIA's regular members, who act as the majority clearing members of the U.S. exchanges, handle more than 90% of the customer funds held for trading on U.S. futures exchanges.

The **International Swaps and Derivatives Association** is the largest global financial trade association, by number of member firms. ISDA was chartered in 1985, and today has over 800 member institutions from 56 countries on six continents. These members include most of the world's institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter ("OTC") derivatives to manage efficiently the financial market risks inherent in their core economic activities.

The **Securities Industry and Financial Markets Association** brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.