sifma
Invested in America

August 7, 2015

**By e-mail**

Brent Fields
Secretary, 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; File No. S7-25-11 (the "Proposed Rules")**[1]

Dear Mr. Fields:

The Securities Industry and Financial Markets Association ("**SIFMA**")[2] appreciates the opportunity to provide the Securities and Exchange Commission (the "**SEC**") with additional comments on the external business conduct standards for security-based swap ("**SBS**") dealers and major SBS participants (together "**SBS Entities**") contained in the Proposed Rules. We intend to submit additional comments separately on the other provisions of the Proposed Rules (15Fh-3(h) (Supervision) and 15Fk-1 (Designation of Chief Compliance Officer for SBS Entities)).

Our comments are informed by SIFMA members' experiences complying with the parallel external business conduct standards adopted by the Commodity Futures Trading Commission ("**CFTC**") in 2012 for swap dealers and major swap participants (together, "**Swap Entities**") (the "**CFTC EBC Rules**").[3] We have provided our comments in the attached matrix, which includes (i) the text of the Proposed Rules with our recommended modifications underlined and bolded and (ii) explanations for why we believe the SEC should adopt those modifications.

---

1 Release No. 34-69491, 76 Fed. Reg. 42396 (July 18, 2011).

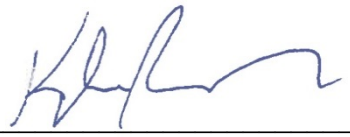
2 SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

3 77 Fed. Reg. 9734 (April 17, 2012).

As described in more detail in the attached matrix, our recommended modifications are generally intended to harmonize the Proposed Rules with the CFTC EBC Rules. We believe consistency is important because most SBS Entities and their counterparties have already invested significant resources to comply and familiarize themselves with the CFTC EBC Rules. To the extent the two rule sets are consistent, it therefore will speed implementation, minimize counterparty confusion and lead to lower costs for SBS Entities and their counterparties.

We would be pleased to provide further information or assistance at the request of the SEC or its staff. Please do not hesitate to contact the undersigned, if you should have any questions with regard to the foregoing.

Respectfully submitted,



Kyle Brandon
Managing Director

Enclosure

**SIFMA's Recommended Modifications to the Proposed Rules**

| Recommended Modifications | Discussion |
|---|---|
| § 240.15Fh-1 **Scope.**<br><br>Sections 240.15Fh-1 through 240.15Fh-6, and 240.15Fk-1 are not intended to limit, or restrict, the applicability of other provisions of the federal securities laws, including but not limited to Section 17(a) of the Securities Act of 1933 and Sections 9 and 10(b) of the Act, and rules and regulations thereunder, or other applicable laws and rules and regulations. Sections 240.15Fh-1 through 240.15Fh-6, and 240.15Fk-1 apply, as relevant, in connection with entering into security-based swaps and continue to apply, as appropriate, over the term of executed security-based swaps~~.~~**, provided, however, that Sections 240.15Fh-3(a) through (f), 240.15Fh-4 and 240.15Fh-5 shall not apply to a security-based swap:**<br><br>**(a) executed prior to the compliance date for this subpart, including any partial or full termination of such security-based swap prior to its scheduled maturity date;**<br><br>**(b) resulting from the exercise of an option on that security-based swap where the option was executed prior to the compliance date for this subpart; or**<br><br>**(c) between a security-based swap dealer or major security-based swap participant and a person controlling, controlled by, or under common control with the security-based swap dealer or major security-based swap participant.** | These modifications would clarify the applicability of the Proposed Rules to legacy SBS and inter-affiliate SBS. They would be consistent with relevant CFTC guidance, with the following exceptions:<br><br>(i) Early terminations of legacy SBS would expressly be excluded. The absence of clear guidance from the CFTC on this topic has often prevented legacy counterparties from exiting their positions in a timely manner;<br><br>(ii) SBS resulting from the exercise of an option on an SBS executed prior to the compliance date would expressly be excluded. Otherwise, an SBS Entity that is party to such option would immediately be noncompliant upon the exercise of such option; and<br><br>(iii) A "common control" standard would be used for the inter-affiliate exception, instead of the more ambiguous "arms' length" standard used by the CFTC. |

| Recommended Modifications | Discussion |
|---|---|
| § 240.15Fh-2 **Definitions.**<br><br>(a) Act as an advisor to a special entity. A security-based swap dealer acts as an advisor to a special entity when it recommends a security-based swap or a trading strategy that involves the use of a security-based swap **that is tailored** to the **particular needs or characteristics of the** special entity, unless:<br><br>**(1) With respect to a special entity that is an employee benefit plan as defined in § 240.15Fh-2(e)(3):**<br><br>**(i) The special entity represents in writing that it has a fiduciary as defined in Section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) that is responsible for representing the special entity in connection with the security-based swap transaction;**<br><br>**(ii) The fiduciary represents in writing that it will not rely on recommendations provided by the security-based swap dealer; and**<br><br>**(iii) The special entity represents in writing:**<br><br>**(A) That it will comply in good faith with written policies and procedures reasonably designed to ensure that any recommendation the special entity receives from the security-based swap dealer materially affecting a security-based swap transaction is evaluated by a fiduciary before the transaction occurs; or**<br><br>**(B) That any recommendation the special entity receives from the security-based swap dealer materially affecting a security-based swap transaction will be evaluated by a fiduciary before that transaction occurs; or**<br><br>**(2) With respect to any special entity:**<br><br>**(i) The security-based swap dealer does not express an opinion as to whether the** | These modifications would harmonize the SEC and CFTC standards for when a dealer is considered to act as an advisor to a special entity by:<br><br>(i) Clarifying that, in order for an SBS dealer to become an advisor as a result of making a recommendation to a special entity, the recommendation must be tailored to the particular needs and characteristics of the special entity. This modification would also help to make the definition more consistent with applicable guidance under the Investment Advisers Act of 1940 (the "**Advisers Act**");<br><br>(ii) Creating a safe harbor relating to employee benefit plans subject to Title I of the Employee Retirement Income Security Act of 1974 ("**ERISA**") that recognizes the unique fiduciary regime already applicable to such special entities;<br><br>(iii) Adding a requirement that, to satisfy the non-ERISA special entity safe harbor, an SBS dealer may not express an opinion as to whether a special entity should enter into the recommended SBS or SBS trading strategy; and |

| Recommended Modifications | Discussion |
|---|---|
| **special entity should enter into a recommended security-based swap or trading strategy involving a security-based swap that is tailored to the particular needs or characteristics of the special entity;**<br><br>**(ii)** The special entity represents in writing that:<br><br>(~~i~~**A**) The special entity will not rely on recommendations provided by the security-based swap dealer; and<br><br>(~~ii~~**B**) The special entity will rely on advice from a qualified independent representative as defined in § 240.15Fh-5(a); and<br><br>~~(2) The security-based swap dealer has a reasonable basis to believe that the special entity is advised by a qualified independent representative as defined in § 240.15Fh-5(a); and~~<br><br>(3) The security-based swap dealer discloses to the special entity that it is not undertaking to act in the best interest of the special entity, as otherwise required by Section 15F(h)(4) of the Act. | (iv) Deleting the safe harbor condition that an SBS dealer have a reasonable basis to believe that the special entity is advised by a qualified independent representative, which is not present in the parallel CFTC EBC Rule nor necessary in light of the fact that the SBS dealer will already receive a written representation that the special entity will rely on advice from such a representative. |
| (b) Eligible contract participant means any person as defined in Section 3(a)(6~~6~~**5**) of the Act **and applicable rules and interpretations of the Commission and the Commodity Futures Trading Commission**. | These modifications correct the cross-reference to the Securities Exchange Act of 1934 (the "**Exchange Act**") and incorporate the joint SEC-CFTC rulemaking adopted in May 2012. |
| (c) Independent representative of a special entity.<br><br>(1) A representative of a special entity must be independent of the security-based swap dealer or major security-based swap participant that is the counterparty to a proposed security-based swap. | These modifications would harmonize the SEC and CFTC standards for when a qualified representative of a special entity is considered to be independent of a Swap or SBS Entity, replacing a restriction on revenues received by the representative |

| Recommended Modifications | Discussion |
|---|---|
| (2) A representative of a special entity is independent of a security-based swap dealer or major security-based swap participant if the representative does not have a relationship with the security-based swap dealer or major security-based swap participant, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the representative.<br><br>(3) A representative of a special entity will be deemed to be independent of a security-based swap dealer or major security-based swap participant if:<br><br>(i) The representative is not and, within one year **of representing the special entity in connection with the security-based swap**, was not an associated person of the security-based swap dealer or major security-based swap participant; ~~and~~<br><br>(ii) **There is no principal relationship between the representative of the special entity and the security-based swap dealer or major security-based swap participant;**<br><br>**(iii) The representative:**<br><br>**(A) Provides timely and effective disclosures to the special entity of all material conflicts of interest that could reasonably affect the judgment or decision making of the representative with respect to its obligations to the special entity; and**<br><br>**(B) Complies with policies and procedures reasonably designed to manage and mitigate such material conflicts of interest;**<br><br>**(iv) The representative is not directly or indirectly, through one or more persons, controlled by, in control of, or under common control with the security-based swap dealer or major security-based swap participant; and**<br><br>**(v) The security-based swap dealer or major security-based swap participant did not refer, recommend, or introduce the representative to the special entity within** | from the SBS Entity with a restriction on referrals by the SBS Entity and adding several additional requirements and restrictions intended to ensure the representative's independence.<br><br>The CFTC's standard has, in our members' experiences, proved sufficient to ensure the independence of special entity representatives and mitigate possible conflicts of interest, while also establishing an objective standard that special entities can apply in practice. As a result, we believe harmonization would achieve the Proposed Rules' intended objective while also minimizing the extent to which SBS Entities and special entities need to incur significant additional costs. |

| Recommended Modifications | Discussion |
|---|---|
| **one year of the representative's representation of the special entity in connection with the security-based swap.**<br><br>**(4) The term "principal relationship" means where a security-based swap dealer or major security-based swap participant is a principal of the representative of a special entity or the representative of the special entity is a principal of the security-based swap dealer or major security-based swap participant. The term "principal" means any person listed in 17 C.F.R. § 3.1(a)(1) through (3).**<br><br>~~The representative has not received more than ten percent of its gross revenues over the past year, directly or indirectly from the security-based swap dealer or major security-based swap participant.~~<br><br>(d) Security-based swap dealer or major security-based swap participant includes, where relevant, **any person acting for or on behalf of the security-based swap dealer or major security-based swap participant, including** an associated person of the security-based swap dealer or major security-based swap participant. | This modification would clarify when an agent of an SBS Entity is subject to business conduct standards by harmonizing the Proposed Rules with the relevant CFTC EBC Rules.<br><br>In connection with adopting such standards, the SEC should work with the Financial Industry Regulatory Authority to ensure that securities sales practice rules applicable to broker-dealers that are, or are acting on behalf of, SBS Entities are consistent with the SEC's SBS business conduct standards, such as by exempting such a broker-dealer from otherwise applicable securities sales practice rules in connection with its SBS activities if it complies with the relevant SBS business conduct standards. |

| Recommended Modifications | Discussion |
|---|---|
| (e) Special entity means:<br><br>(1) A Federal agency;<br><br>(2) A State, State agency, city, county, municipality, or other political subdivision of a State **or any instrumentality, department, or a corporation of or established by a State or political subdivision of a State**;<br><br>(3) Any employee benefit plan~~, as defined in section 3~~**subject to Title I** of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002);<br><br>(4) Any governmental plan, as defined in section 3(32) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(32)); ~~or~~<br><br>(5) Any endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986**; or**<br><br>**(6) Any employee benefit plan defined in Section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002), not otherwise defined as a special entity, that elects to be a Special Entity by notifying a security-based swap dealer or major security-based swap participant of its election prior to entering into a security-based swap with the particular security-based swap dealer or major security-based swap participant**. | These modifications would harmonize the SEC and CFTC special entity definitions by limiting covered employee benefit plans to those subject to the fiduciary responsibility provisions of ERISA, such as funded pension and welfare plans, while still allowing other employee benefit plans, such as church plans, to opt in to special entity protections.[4]<br><br>In addition, the SEC should make the following interpretive clarifications also made by the CFTC:<br><br>(i) Master trusts sponsored by one or more employers should be treated as special entities because no individual constituent ERISA plan would receive any additional protection if the SBS Entity had to separately comply with the Proposed Rules with respect to such ERISA plan;<br><br>(ii) The SEC should not look through an entity that is an investment vehicle, such as a bank collective trust fund or a plan asset hedge fund, to see if the collective investment vehicles have special entity |

[4] These changes are necessary to avoid rendering Rule 15Fh-2(e)(4) superfluous because an employee benefit plan "defined in" section 3 of ERISA includes government plans defined in section 3(32) of ERISA. The CFTC, in this same situation, refined the definition of "employee benefit plan" to mean an employee benefit plan subject to Title I of ERISA. Because this change also has the effect of excluding certain other types of employee benefit plans from special entity status, the CFTC adopted a rule to permit such a plan to opt into special entity status, which we would include as Rule15Fh-2(e)(6).

| Recommended Modifications | Discussion |
| --- | --- |
| | participants. There is no indication that Congress intended the SEC to "look through" collective investment vehicles to apply the special entity protections in the Proposed Rules to constituent special entities and the statutory definition of "special entity" does not mention collective investment vehicles; and<br><br>(iii) Consistent with the plain reading of the statute, a charitable organization that has entered into an SBS for which its counterparty has recourse to the organization's endowment should not be treated as a special entity. |
| (f) A person is subject to a statutory disqualification for purposes of § 240.15Fh-5 if that person would be subject to a statutory disqualification under the provisions of Section 3(a)(39) of the Act**, provided, however, that a security-based swap dealer or major security-based swap participant that is also registered with the Commodity Futures Trading Commission as a swap dealer or major swap participant or affiliated with a registered swap dealer or major swap participant shall, for purposes of § 240.15Fh-5, be deemed to have a reasonable basis to believe that a person is not subject to a statutory disqualification if such dually registered security-based swap dealer or major security-based swap participant has a reasonable basis to believe that the person is not subject to a statutory disqualification as defined in 17 C.F.R. § 23.450**. | Although the statutory disqualification standards under the Exchange Act and the Commodity Exchange Act differ somewhat, both cover comparable types of disqualifying events. Accordingly, requiring a dual registrant (or an SBS Entity affiliated with a registered Swap Entity) to apply different standards in the contexts of its swap and SBS trading activities would impose substantial costs, such as duplicative diligence and documentation requirements, without material countervailing benefits. This modification would address that issue by permitting such an SBS Entity to ascertain whether a special entity's representative is |

| Recommended Modifications | Discussion |
|---|---|
| | subject to a statutory disqualification for purposes of Rule 15Fh-5 based on information it obtained to ensure compliance with the parallel CFTC EBC Rule. |
| § 240.15Fh-3 **Business conduct requirements.**<br><br>(a) Counterparty Status.<br><br>(1) Eligible contract participant. A security-based swap dealer or a major security-based swap participant shall verify that a counterparty whose identity is known to the security-based swap dealer or a major security-based swap participant prior to the execution of the transaction meets the eligibility standards for an eligible contract participant, before entering into a security-based swap with that counterparty other than on a registered national securities exchange or registered **or exempt** security-based swap execution facility.<br><br>(2) Special entity. A security-based swap dealer or a major security-based swap participant shall verify whether a counterparty whose identity is known to the security-based swap dealer or a major security-based swap participant prior to the execution of the transaction is a special entity, before entering into a security-based swap with that counterparty **other than on a registered national securities exchange or registered or exempt security-based swap execution facility**.<br><br>**(3) Special entity election. In verifying the eligibility of a counterparty pursuant to paragraph (a) of this section, a security-based swap dealer or major security-based swap participant shall verify whether a counterparty is eligible to elect to be a special entity under § 240.15Fh-2(e)(6) and, if so, notify such counterparty of its right to make such an election.** | These modifications would conform the scope of verification requirements for exchange-traded SBS so that they are the same for eligible contract participants and for special entity counterparties. They also would conform the special entity verification requirement to the modified special entity definition described above. In addition, they would codify the SEC's guidance regarding reliance on written representations in the rule, consistent with the parallel CFTC EBC Rule. Finally, they would address the treatment of SBS executed on an exempt SBS execution facility, such as a foreign SBS execution facility that the SEC determines to be subject to a comparable home country regime.[5] |

[5] *See* Release No. 34-69490; 78 Fed. Reg. 30967, 31055-57 (May 1, 2013) (proposed exemption for SBS execution facilities).

| Recommended Modifications | Discussion |
|---|---|
| **(4) Safe harbor. A security-based swap dealer or major security-based swap participant may rely on written representations of a counterparty to satisfy the requirements of this section as provided in § 240.15Fh-3(i). A security-based swap dealer or major security-based swap participant will have a reasonable basis to rely on such written representations for purposes of the requirements in paragraphs (a) and (b) of this section if the counterparty specifies in such representations the provision(s) of Section 1a(18) of the Commodity Exchange Act or applicable rules or interpretations of the Commission and the Commodity Futures Trading Commission that describe its status as an eligible contract participant and, in the case of a special entity, the paragraph(s) of the special entity definition in § 240.15Fh-2(e) that define its status as a special entity.** | |
| (b) Disclosure. **At a reasonably sufficient time prior to**~~Before~~ entering into a security-based swap, a security-based swap dealer or major security-based swap participant shall disclose to the counterparty, other than a security-based swap dealer, major security-based swap participant, swap dealer or major swap participant, **material** information concerning the security-based swap in a manner reasonably designed to allow the counterparty to assess: | These modifications would harmonize the CFTC and SEC disclosure rules, which would clarify (i) when an SBS Entity must provide the required disclosure and (ii) that such disclosure relates to "material" information. |
| (1) Material risks and characteristics. The material risks and characteristics of the particular security-based swap, including **(i) market, credit, liquidity, foreign currency, legal, operational, and any other applicable risks; and (ii) the material economic terms of the security-based swap, the terms relating to the operation of the security-based swap, and the rights and obligations of the parties during the term of the security-based swap**~~, but not limited to, 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 security-based swap to those factors and conditions, and the approximate magnitude of the gains or losses the security-based swap will experience under specified circumstances~~. | These modifications would generally harmonize the CFTC EBC Rules and the Proposed Rules governing the content of material risks and characteristics disclosures. Such harmonization would help support the continued development of standard disclosures, which reduce compliance costs and prevent undue delays in execution. Harmonization would also reduce the likelihood of inconsistent disclosures for similar products, such as broad-based indices and |

| Recommended Modifications | Discussion |
|---|---|
| | single-name swaps, and thus reduce the likelihood of counterparty confusion.<br><br>However, we do not recommend that the SEC include a requirement for an SBS dealer to disclose that it will provide a scenario analysis upon counterparty request. That requirement was not proposed by the SEC. In addition, in our members' experience, the CFTC's scenario analysis requirement has complicated the ability of SBS dealers to respond to counterparty requests for different pricing scenarios and to volunteer different pricing scenarios to less experienced counterparties by creating uncertainty as to when those scenarios must satisfy the requirements for scenario analysis set forth in the CFTC EBC Rules.[6] |
| (2) Material incentives or conflicts of interest. Any material incentives or conflicts of interest that the security-based swap dealer or major security-based swap participant may have in connection with the security-based swap, including any compensation or other incentives from any source other than the counterparty in connection with the security-based swap to be entered into with the counterparty.<br><br>(3) Record. The security-based swap dealer or major security-based swap participant | The SEC's proposed requirement to disclose material incentives and conflicts of interest is already consistent with the parallel CFTC requirement, except that the SEC's proposed requirement would not mandate disclosure of a pre-trade mid-market mark. We do not believe that the |

[6] If, however, the SEC does adopt a scenario analysis disclosure requirement, then it should be consistent with CFTC EBC Rule 23.431(b) (*i.e.*, only applicable to SBS that are not made "available to trade" on an SBS execution facility or national securities exchange, only require an SBS dealer to provide scenario analysis upon counterparty request, require that the scenario analysis be designed in consultation with the counterparty, and not require that the SBS dealer disclose confidential, proprietary information about any model it may use to prepare the scenario analysis).

| Recommended Modifications | Discussion |
|---|---|
| shall make a written record of the non-written disclosures made pursuant to this subsection (b), and provide a written version of these disclosures to its counterparties in a timely manner, but in any case no later than the delivery of the trade acknowledgement of the particular transaction pursuant to § 240.15Fi-1. | SEC should adopt a pre-trade mid-market mark disclosure requirement. The CFTC has provided relief from such requirement for many types of swaps (*see* CFTC No-Action Letters 12-42, 12-58 and 13-12). For swaps that remain subject to the requirement, counterparties frequently request that Swap Entities either refrain from providing the required pre-trade mid-market mark or send such marks to a rarely monitored e-mail address, due to the limited benefits of such disclosure to them and the artificial impediment it presents to the prompt execution of transactions. |
| **(4) Exemption. The requirements of this § 240.15Fh-3(b) shall not apply with respect to a security-based swap that is intended to be cleared if:**<br><br>**(i) The security-based swap is (A) executed on a registered or exempt security-based swap execution facility or registered national securities exchange and (B) of a type that is, as of the date of execution, required to be cleared pursuant to Section 3C of the Act; or**<br><br>**(ii) The security-based swap dealer or major security-based swap participant does not know the identity of the counterparty, at any time up to and including execution of the transaction.** | Adding this exemption would harmonize the scope of the SEC's disclosure requirements with the scope of the parallel CFTC requirements under the relief provided by CFTC No-Action Letter 13-70. That no-action relief was adopted by the CFTC based on the following considerations: (i) the impossibility or impracticability of compliance with certain rules by a Swap Entity when the identity of the counterparty is not known prior to execution; (ii) the likelihood that swaps initiated anonymously on a designated contract market or swap execution facility will be standardized and, thus, information about the material |

| Recommended Modifications | Discussion |
| --- | --- |
| | risks and characteristics of such swaps is likely to be available from the designated contract market or swap execution facility or other widely available source (including the product specifications of a derivatives clearing organization where the swaps are accepted for clearing); and (iii) the likelihood that such relief would provide an incentive to transact on designated contract markets and swap execution facilities, thus enhancing transparency in the swaps market. We believe that similar considerations apply in the SBS market. |
| (c) Daily Mark. A security-based swap dealer or major security-based swap participant shall disclose the daily mark to the counterparty, other than a security-based swap dealer, major security-based swap participant, swap dealer or major swap participant, which shall be: | |
| (1) For a cleared security-based swap, **notify the counterparty of its right to receive**, upon ~~the~~ request ~~of the counterparty~~, the daily ~~end-of-day settlement price that the security-based swap dealer or major security-based swap participant receives~~**mark** from the appropriate clearing agency; and | These modifications would harmonize the daily mark disclosure requirement for cleared SBS with the parallel CFTC requirement, which is somewhat less prescriptive with respect to its description of the clearinghouse's mark.<br><br>We also believe the SEC should, like the CFTC, provide guidance clarifying that an SBS Entity shall be deemed to satisfy this requirement if the counterparty has agreed to receive its daily mark for cleared SBS |

| Recommended Modifications | Discussion |
| --- | --- |
| | from its clearing member. This clarification is necessary because an SBS Entity may not always be in a position to provide its counterparty with the clearing agency's daily mark (*e.g.*, if the SBS Entity no longer holds a position in the relevant SBS, it will no longer receive a mark from the clearing agency). In addition, if the SBS Entity was dually registered as a Swap Entity (or affiliated with a registered Swap Entity), and its counterparty had previously agreed to receive daily marks for cleared swaps from its clearing futures commission merchant, then such SBS Entity should be permitted to rely on that agreement in connection with cleared SBS so long as it has notified its counterparty that it intends to so rely and the counterparty has not objected in writing. |
| (2) For an uncleared security-based swap, the midpoint between the bid and offer, or the calculated equivalent thereof, as of the close of business, unless the parties agree in writing otherwise to a different time, on each business day during the term of the security-based swap. The daily mark may be based on market quotations for comparable security-based swaps, mathematical models or a combination thereof. The security-based swap dealer or major security-based swap participant shall also disclose ~~its data sources and a description of~~ the methodology and assumptions used to prepare the daily mark, and promptly disclose any material changes to such ~~data sources,~~ methodology and assumptions during the term of the security-based swap**; provided, however, that the security-based swap dealer or major security-based swap participant is not required to disclose to the counterparty confidential, proprietary information about** | Both the SEC and CFTC would require that the daily mark for an uncleared transaction be calculated as a mid-market price, and so we do not believe that additional harmonization is necessary in connection with the methodology for calculating such daily marks.<br><br>However, the CFTC also provided additional clarifications regarding the disclosure that should accompany daily |

| Recommended Modifications | Discussion |
|---|---|
| **any model it may use to prepare the daily mark. The security-based swap dealer or major security-based swap dealer shall also disclose additional information concerning the daily mark to ensure a fair and balanced communication, including, as appropriate, that: (i) the daily mark may not necessarily be a price at which either the counterparty or the security-based swap dealer or major security-based swap participant would agree to replace or terminate the security-based swap; (ii) depending upon the agreement of the parties, calls for margin may be based on considerations other than the daily mark provided to the counterparty; and (iii) the daily mark may not necessarily be the value of the security-based swap that is marked on the books of the security-based swap dealer or major security-based swap participant**. | marks. We believe it would be helpful to include those clarifications in the parallel SEC rule so that counterparties are not confused by inconsistent disclosures across their uncleared swap and SBS positions. |
| (d) Disclosure Regarding Clearing Rights. A security-based swap dealer or major security-based swap participant shall disclose the following information to a counterparty, other than a security-based swap dealer, major security-based swap participant, swap dealer or major swap participant:<br><br>(1) For security-based swaps subject to clearing requirement. Before entering into a security-based swap subject to the clearing requirement under Section 3C(a) of the Act, a security-based swap dealer or major security-based swap participant shall~~:~~<br><br>~~(i) Disclose to the counterparty the names of the clearing agencies that accept the security-based swap for clearing, and through which of those clearing agencies the security-based swap dealer or major security-based swap participant is authorized or permitted, directly or through a designated clearing member, to clear the security-based swap; and~~<br><br>~~(ii) N~~**n**otify the counterparty that it shall have the sole right to select which ~~of the~~ clearing agenc**y**~~ies described in paragraph (d)(1)(i)~~ shall be used to clear the security-based swap.<br><br>(2) For security-based swaps not subject to clearing requirement. Before entering into a | Deleting the proposed requirements that an SBS Entity disclose the names of the clearing agencies that accept an SBS for clearing and through which the SBS Entity is authorized to clear the SBS would harmonize the SEC's clearing rights disclosure requirement with the parallel CFTC requirement. Given the limited number of SBS clearing agencies, such additional disclosure is unlikely to be necessary in any event. If such number increases in the future, the SEC could consider adopting such an additional disclosure requirement at that time. |

| Recommended Modifications | Discussion |
| --- | --- |
| security-based swap not subject to the clearing requirement under Section 3C(a) of the Act, a security-based swap dealer or major security-based swap participant shall~~:~~<br><br>~~(i) Determine whether the security-based swap is accepted for clearing by one or more clearing agencies;~~<br><br>~~(ii) Disclose to the counterparty the names of the clearing agencies that accept the security-based swap for clearing, and whether the security-based swap dealer or major security-based swap participant is authorized or permitted, directly or through a designated clearing member, to clear the security-based swap through such clearing agencies; and~~<br><br>~~(iii) N~~**n**otify the counterparty that it may elect to require clearing of the security-based swap and shall have the sole right to select the clearing agency at which the security-based swap will be cleared, provided it is a clearing agency at which the security-based swap dealer or major security-based swap participant is authorized or permitted, directly or through a designated clearing member, to clear the security-based swap.<br><br>(3) Record. The security-based swap dealer or major security-based swap participant shall make a written record of the non-written disclosures made pursuant to this subsection (d), and provide a written version of these disclosures to its counterparties in a timely manner, but in any case no later than the delivery of the trade acknowledgement of the particular transaction pursuant to § 240.15Fi-1.<br><br>**(4) Exemption. The requirements of this § 240.15Fh-3(d) shall not apply with respect to a security-based swap that is intended to be cleared if:**<br><br>**(i) The security-based swap is (A) executed on a registered or exempt security-based swap execution facility or registered national securities exchange and (B) of a type that is, as of the date of execution, required to be cleared pursuant to Section 3C of the Act; or** | Adding this exemption would harmonize the scope of the SEC's disclosure requirements with the scope of the parallel CFTC requirements under the relief provided by CFTC No-Action Letter 13-70. *See* the discussion accompanying Rule 15Fh-3(b)(4) for a more detailed description of the rationale for this |

| Recommended Modifications | Discussion |
|---|---|
| **(ii) The security-based swap dealer or major security-based swap participant does not know the identity of the counterparty, at any time up to and including execution of the transaction.** | exemption. |
| (e) Know Your Counterparty. Each security-based swap dealer shall establish, maintain and enforce policies and procedures reasonably designed to obtain and retain a record of the essential facts concerning each counterparty **(other than a counterparty to a swap that is intended to be cleared, executed on a registered or exempt security-based swap execution facility or registered national securities exchange and of a type that is, as of the date of execution, required to be cleared pursuant to Section 3C of the Act)** whose identity is known to the security-based swap dealer, that are necessary for conducting business with such counterparty. For purposes of this section, the essential facts concerning a counterparty are:<br><br>(1) Facts required to comply with applicable laws, regulations and rules;<br><br>(2) Facts required to implement the security-based swap dealer's credit and operational risk management policies in connection with transactions entered into with such counterparty; **and**<br><br>(3) Information regarding the authority of any person acting for such counterparty~~; and~~ | Adding an exception for exchange-traded and cleared SBS would harmonize the scope of the SEC's know-your-counterparty requirements with the scope of the parallel CFTC requirements under the relief provided by CFTC No-Action Letter 13-70. *See* the discussion accompanying Rule 15Fh-3(b)(4) for a more detailed description of the rationale for this exception. |
| ~~(4) If the counterparty is a special entity, such background information regarding the independent representative as the security-based swap dealer reasonably deems appropriate~~. | Deleting proposed Rule 15Fh-3(e)(4) would harmonize SEC and CFTC requirements regarding the essential facts that must be obtained from a counterparty. Also, the deleted provision would largely duplicate requirements already applicable under Rule 15Fh-5. |
| (f) Recommendations of Security-Based Swaps or Trading Strategies. | |

| Recommended Modifications | Discussion |
| --- | --- |
| (1) A security-based swap dealer that recommends a security-based swap or trading strategy involving a security-based swap to a counterparty, other than a security-based swap dealer, major security-based swap participant, swap dealer, or major swap participant, must ~~have a reasonable basis to believe~~:<br><br>(i) ~~Based on~~**Undertake** reasonable diligence~~, that~~ **to understand the potential risks and rewards associated with** the recommended security-based swap or trading strategy involving a security-based swap ~~is suitable for at least some counterparties~~; and<br><br>(ii) **Have a reasonable basis to believe t**~~T~~hat a recommended security-based swap or trading strategy involving a security-based swap is suitable for the counterparty. To establish a reasonable basis for a recommendation, a security-based swap dealer must have or obtain relevant information regarding the counterparty, including the counterparty's investment profile, trading objectives, and its ability to absorb potential losses associated with the recommended security-based swap or trading strategy.<br><br>(2) A security-based swap dealer may also fulfill its obligations under paragraph (f)(1)**(ii)** with respect to a particular counterparty if:<br><br>(i) The security-based swap dealer reasonably determines that the counterparty, or an agent to which the counterparty has delegated decision-making authority, is capable of independently evaluating investment risks with regard to the relevant security-based swap or trading strategy involving a security-based swap;<br><br>(ii) The counterparty or its agent affirmatively represents in writing that it is exercising independent judgment in evaluating the recommendations of the security-based swap dealer; ~~and~~<br><br>(iii) The security-based swap dealer discloses that it is acting in its capacity as a counterparty, and is not undertaking to assess the suitability of the security-based swap or trading strategy for the counterparty; **and** | These modifications would harmonize SEC and CFTC suitability requirements. We believe harmonization is warranted here because the CFTC EBC Rule addresses the same objectives as the Proposed Rule. Although conforming to the CFTC EBC Rule would impose additional diligence and compliance requirements on the SBS dealer, these requirements would not result in material costs because SBS dealers are already complying with the same requirements under the parallel CFTC EBC Rule. In addition, harmonization would result in a lower likelihood of counterparty confusion. |

| Recommended Modifications | Discussion |
|---|---|
| **(iv) In the case of a counterparty that is a special entity, the security-based swap dealer complies with § 240.15Fh-4(b) where the recommendation would cause the swap dealer to act as an advisor to a special entity within the meaning of § 240.15Fh-2(a)**.<br><br>(3) A security-based swap dealer will be deemed to have satisfied its obligations under paragraph (f)(~~1~~**2**)**(i)** ~~with respect to a special entity~~ **if it receives written representations that**:<br><br>(i) ~~The security-based swap dealer is acting as an advisor to the~~**In the case of a counterparty that is not a** special entity~~ and complies with the requirements of § 240.15Fh-4(b)~~**, the counterparty has complied in good faith with written policies and procedures that are reasonably designed to ensure that the persons responsible for evaluating the recommendation and making trading decisions on behalf of the counterparty are capable of doing so**; or<br><br>(ii) ~~The security-based swap dealer is deemed not to be acting as an advisor to the~~**In the case of a counterparty that is a** special entity~~ pursuant to~~**, satisfy the terms of the safe harbor in** § 240.15Fh-~~2(a)~~**5(b)**.<br><br>(g) Fair and Balanced Communications. A security-based swap dealer or major security-based swap participant shall communicate with counterparties in a fair and balanced manner based on principles of fair dealing and good faith. In particular:<br><br>(1) Communications must provide a sound basis for evaluating the facts with regard to any particular security-based swap or trading strategy involving a security-based swap;<br><br>(2) Communications may not imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast; and<br><br>(3) Any statement referring to the potential opportunities or advantages presented by a security-based swap shall be balanced by an equally detailed statement of the | |

| Recommended Modifications | Discussion |
|---|---|
| corresponding risks.<br><br>(h) Supervision.<br><br>[Reserved.]<br><br>**(i) Reasonable reliance on representations.**<br><br>**(1) A security-based swap dealer or major security-based swap participant may rely on the written representations of a counterparty to satisfy its due diligence requirements under this subpart, unless it has information that would cause a reasonable person to question the accuracy of the representation. If agreed to by the counterparties, such representations may be contained in counterparty relationship documentation and may satisfy the relevant requirements of this subpart for subsequent security-based swaps offered to or entered into with a counterparty, provided, however, that such counterparty undertakes to timely update any material changes to the representations.**<br><br>**(2) Unless the counterparty provides written notice to the contrary, a security-based swap dealer or major security-based swap participant that is also registered with the Commodity Futures Trading Commission as a swap dealer or major swap participant (or affiliated with a registered swap dealer or major swap participant) and has previously provided a counterparty with the notice described in paragraph (i)(3) may, in lieu of relying on written representations of the counterparty with respect to the matters covered by this subpart, instead rely on written representations of the counterparty with respect to the matters covered by subpart H of part 23 of the regulations of the Commodity Futures Trading Commission.**<br><br>**(3) To be eligible for paragraph (i)(2), the security-based swap dealer or major** | We plan to address the SEC's proposed SBS Entity supervision rule in a later comment letter.<br><br>Adding this provision would, consistent with the parallel CFTC EBC Rules and one of the proposals contained in the preamble to the Proposed Rules,[7] clarify the circumstances under which an SBS Entity may rely on the written representations of its counterparty.<br><br>This provision would facilitate the ability of SBS Entities to rely on equivalent representations received from counterparties in connection with the CFTC EBC Rules while still allowing counterparties to notify SBS Entities if they should not rely on those representations for purposes of the SEC's rules. Allowing SBS Entities to rely on such representations would significantly speed implementation and lower costs, |

[7] *See* 76 Fed. Reg. at 42402 ("[W]e preliminarily believe that, absent special circumstances, it would be appropriate for SBS Entities to rely on counterparty representations in connection with certain specific requirements under the proposed rules.").

| Recommended Modifications | Discussion |
|---|---|
| **security-based swap participant must provide its counterparty with a prominent written notice that, unless the counterparty notifies the security-based swap dealer or major security-based swap participant to the contrary in writing, the security-based swap dealer or major security-based swap participant will, for purposes of §§ 240.15Fh-1 through 240.15Fh-6, rely on the written representations of the counterparty with respect to the matters covered by subpart H of Part 23 of the regulations of the Commodity Futures Trading Commission.**<br><br>**(4) Receipt by a security-based swap dealer or major security-based swap participant of written notice from a counterparty that the security-based swap dealer or major security-based swap participant may not, for purposes of §§ 240.15Fh-1 through 240.15Fh-6, rely on the written representations of the counterparty with respect to the matters covered by subpart H of Part 23 of the regulations of the Commodity Futures Trading Commission shall not affect any reliance by the security-based swap dealer or major security-based swap participant on such representations in connection with a security-based swap or trading strategy involving a security-based swap that was offered, recommended or entered into by the security-based swap dealer or major security-based swap participant to or with the counterparty prior to receiving such notice.** | without reducing counterparty protections. |
| § 240.15Fh-4 **Special requirements for security-based swap dealers acting as advisors to special entities.**<br><br>(a) In general. It shall be unlawful for a security-based swap dealer or major security-based swap participant:<br><br>(1) To employ any device, scheme, or artifice to defraud any special entity or prospective customer who is a special entity;<br><br>(2) To engage in any transaction, practice, or course of business that operates as a fraud or deceit on any special entity or prospective customer who is a special entity; or | Proposed Rules 15Fh-4(a)(1) and (2) would apply to conduct with special entities, whereas Proposed Rule 15Fh-4(a)(3) would apply more broadly to fraudulent, deceptive, or manipulative conduct by an SBS Entity with any counterparty. However, the language of (a)(3) is modeled on language in the Advisers Act that applies to conduct by |

| Recommended Modifications | Discussion |
|---|---|
| (3) To engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative.<br><br>**(b) Affirmative defense. It shall be an affirmative defense to an alleged violation of paragraph (a)(2) or (3) of this section for failure to comply with any requirement in this subpart if a security-based swap dealer or major security-based swap participant establishes that the security-based swap dealer or major security-based swap participant:**<br><br>**(1) Did not act intentionally or recklessly in connection with such alleged violation; and**<br><br>**(2) Complied in good faith with written policies and procedures reasonably designed to meet the particular requirement that is the basis for the alleged violation.** | investment advisers. Unlike in the context of the Advisers Act, SBS Entities do not typically act as advisers to counterparties. As a result of these considerations, the CFTC included an affirmative defense in its parallel CFTC EBC Rules, which we have recommended that the SEC include as new Rule 15Fh-4(b). We believe the same considerations that led the CFTC to adopt this approach for Swap Entities apply to SBS Entities. |
| ~~(b)~~**(c)** A security-based swap dealer that acts as an advisor to a special entity regarding a security-based swap shall comply with the following requirements:<br><br>(1) Duty. The security-based swap dealer shall have a duty to ~~act~~**make a reasonable determination that any security-based swap or trading strategy involving a security-based swap recommended by the security-based swap dealer is** in the best interests of the special entity.<br><br>(2) Reasonable Efforts. The security-based swap dealer shall make reasonable efforts to obtain such information that the security-based swap dealer considers necessary to make a reasonable determination that a security-based swap or trading strategy involving a security-based swap is in the best interests of the special entity. This information shall include, but not be limited to: | These modifications to Rule 15Fh-4(c)(1) and (2) would harmonize SEC and CFTC requirements applicable when a dealer acts as an advisor to a special entity by conforming those requirements so that they apply to the specific conduct by the SBS dealer that causes it to be deemed an advisor.<br><br>To promote legal certainty and the ability of SBS dealers to continue to trade with special entities, the SEC should provide guidance clarifying the nature of an SBS dealer's "best interests" duty. These clarifications should be consistent with those provided by the CFTC, *i.e.*¸ that the |

| Recommended Modifications | Discussion |
| --- | --- |
| | best interests duty to a special entity is not a fiduciary duty (and the business conduct standards do not impose a fiduciary duty on an SBS dealer with respect to any other party), but rather a duty for the SBS dealer to (1) comply with the requirement to make a reasonable effort to obtain necessary information, (2) act in good faith and make full and fair disclosure of all material facts and conflicts of interest with respect to the recommended SBS or SBS trading strategy and (3) employ reasonable care that any recommendation made to the special entity be designed to further the special entity's stated objectives. Also, consistent with the CFTC's guidance, the recommendation should not need to be the "best" of all possible hypothetical alternatives; rather, the determination of whether an SBS is in the best interests of the special entity should be analyzed based on information known to the SBS dealer at the time the recommendation is made. In addition, the best interests duty should not prohibit an SBS dealer from negotiating SBS terms in its own interests or making a reasonable profit from a recommended transaction, nor should it necessarily impose an ongoing obligation to act in the best interests of the special entity. |

| Recommended Modifications | Discussion |
| --- | --- |
| ~~(i) The authority of the special entity to enter into a security-based swap;~~<br><br>(i~~i~~) The financial status of the special entity, as well as future funding needs;<br><br>(ii~~i~~) The tax status of the special entity;<br><br>(i**ii**~~v~~) The **hedging,** investment**,** ~~or~~ financing **or other** objectives of the special entity;<br><br>(**i**v) The experience of the special entity with respect to entering into security-based swaps, generally, and security-based swaps of the type and complexity being recommended;<br><br>(v~~i~~) Whether the special entity has the financial capability to withstand changes in market conditions during the term of the security-based swap; and<br><br>(vi~~i~~) Such other information as is relevant to the particular facts and circumstances of the special entity, market conditions and the type of security-based swap or trading strategy involving a security-based swap being recommended.<br><br>**(vii) As provided in §240.15Fh-3(j), the security-based swap dealer may rely on written representations of the special entity to satisfy its requirement in paragraph (b)(2) of this section to make "reasonable efforts" to obtain necessary information.** | In adopting the final CFTC EBC Rules, the CFTC eliminated the requirement to obtain information regarding the authority of the special entity to enter into a swap as duplicative of the know-your-customer requirement under the CFTC EBC Rules. Since Proposed Rule 15Fh-3(e)(3) would require an SBS dealer to obtain this information, we believe the same considerations support eliminating that requirement here.<br><br>Recognizing that a special entity's objectives in using swaps may be broader than investment or financing needs, the final CFTC EBC Rules added "hedging" and "other" to the list of possible special entity objectives. We believe the same to be true of a special entity's use of SBS and thus believe the list of possible objectives should conform to the list in the CFTC EBC Rule.<br><br>We believe that the addition of Rule 15Fh-4(c)(2)(vii) is necessary because special entities are sometimes reluctant to provide complete information to SBS dealers about their investment portfolio or other information that might be relevant to the appropriateness of a particular recommendation. |

| Recommended Modifications | Discussion |
|---|---|
| (3) Exemption. The requirements of this § 240.15Fh-4(~~b~~**c**) shall not apply with respect to a security-based swap **that is intended to be cleared** if:<br><br>(i) The transaction is **(A)** executed on a registered **or exempt** security-based swap execution facility or registered national securities exchange **and (B) of a type that is, as of the date of execution, required to be cleared pursuant to Section 3C of the Act**; ~~and~~**or**<br><br>(ii) The security-based swap dealer does not know the identity of the counterparty, at any time up to and including execution of the transaction. | These modifications to the exception for exchange-traded SBS would harmonize the scope of the SEC's special entity advisor requirements with the scope of parallel CFTC requirements under the relief provided by CFTC No-Action Letter 13-70. *See* the discussion accompanying Rule 15Fh-3(b)(4) for a more detailed description of the rationale for these modifications. |
| § 240.15Fh-5 **Special requirements for security-based swap dealers and major security-based swap participants acting as counterparties to special entities.**<br><br>(a)**(1)** A security-based swap dealer or major security-based swap participant that offers to enter into or enters into a security-based swap with a special entity**, other than a special entity defined in § 240.15Fh-2(e)(3),** must have a reasonable basis to believe that special entity has a qualified independent representative. For these purposes, a qualified independent representative is an independent representative that:<br><br>(~~1~~**i**) Has sufficient knowledge to evaluate the transaction and risks;<br><br>(~~2~~**ii**) Is not subject to a statutory disqualification;<br><br>(~~3~~**iii**) Undertakes a duty to act in the best interests of the special entity;<br><br>(~~4~~**iv**) Makes appropriate and timely disclosures to the special entity ~~of material information concerning the security-based swap~~;<br><br>(~~5~~**v**) ~~Will provide written representations to~~**Evaluates, consistent with any guidelines provided by** the special entity**,** ~~regarding~~ fair pricing and the appropriateness of the security-based swap; and | These modifications would harmonize the SEC's requirements applicable to a special entity's representative with the parallel CFTC requirements by:<br><br>(1) making minor modifications to the qualification criteria for special entity representatives, which would reduce costs for special entities since most of them have already conformed their relationships with their representatives to satisfy the CFTC's qualification criteria;<br><br>(2) adopting a special safe harbor for ERISA special entities, thereby recognizing the unique fiduciary regime already applicable to such special entities; and<br><br>(3) adopting an express safe harbor provision for non-ERISA special entities |

| Recommended Modifications | Discussion |
| --- | --- |
| (6**vi**) ~~In the case of employee benefit plans subject to the Employee Retirement Income Security Act of 1974, is a fiduciary as defined in section 3(21) of that Act (29 U.S.C. 1002(21)); and~~<br><br>~~(7)~~ In the case of a special entity defined in §§ 240.15Fh-2(e)(2) or (4), is a person that is subject to rules of the Commission, the Commodity Futures Trading Commission or a self-regulatory organization subject to the jurisdiction of the Commission or the Commodity Futures Trading Commission prohibiting it from engaging in specified activities if certain political contributions have been made, provided that this **sub-**paragraph (~~7~~**vi**) shall not apply if the independent representative is an employee of the special entity.<br><br>**(2) Any security-based swap dealer or major security-based swap participant that offers to enter or enters into a security-based swap with a special entity as defined in § 240.15Fh-2(e)(3) must have a reasonable basis to believe that the special entity has a representative that is a fiduciary as defined in Section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002).**<br><br>**(b) Safe harbor. (1) A security-based swap dealer or major security-based swap participant shall be deemed to have a reasonable basis to believe that the special entity, other than a special entity defined in § 240.15Fh-2(e)(3), has a representative that satisfies the applicable requirements of paragraph (a)(1) of this section, provided that:**<br><br>**(i) The special entity represents in writing to the security-based swap dealer or major security-based swap participant that it has complied in good faith with written policies and procedures reasonably designed to ensure that it has selected a representative that satisfies the applicable requirements of paragraph (a) of this section, and that such policies and procedures provide for ongoing monitoring of the performance of such representative consistent with the requirements of paragraph (a) of this section; and** | (as opposed to general guidance about an SBS Entity's reliance on representations), which would help speed implementation, reduce costs and mitigate counterparty confusion because most special entities and representatives have already taken steps to ensure that they can provide the representations contained in the CFTC's safe harbor.<br><br>In addition, like the CFTC, the SEC should clarify that the term "offer" means an offer to enter into an SBS that, if accepted, would result in a binding contract under applicable law.<br><br>However, we do not believe that the SEC needs to include a requirement, like the one adopted by the CFTC, for a firm's chief compliance officer to review determinations that the firm does not have a reasonable basis to believe that a special entity's representative meets the relevant criteria. The SEC did not initially propose such a requirement, and the relevant policy objective could be addressed by more principles-based guidance that does not require a review by the firm's chief compliance officer in every instance. |

| Recommended Modifications | Discussion |
| --- | --- |
| **(ii) The representative represents in writing to the special entity and security-based swap dealer or major security-based swap participant that the representative:**<br><br>**(A) Has policies and procedures reasonably designed to ensure that it satisfies the applicable requirements of paragraph (a) of this section;**<br><br>**(B) Meets the independence test in § 240.15Fh-2(c); and**<br><br>**(C) Is legally obligated to comply with the applicable requirements of paragraph (a) of this section by agreement, condition of employment, law, rule, regulation, or other enforceable duty.**<br><br>**(2) A security-based swap dealer or major security-based swap participant shall be deemed to have a reasonable basis to believe that a special entity defined in § 240.15Fh-2(e)(3) has a representative that satisfies the applicable requirements in paragraph (a)(2) of this section, provided that the special entity provides in writing to the security-based swap dealer or major security-based swap participant the representative's name and contact information, and represents in writing that the representative is a fiduciary as defined in Section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002).**<br><br>**(c) Reasonable reliance on representations of the special entity. A security-based swap dealer or major security-based swap participant may rely on written representations of a special entity and, as applicable under this section, the special entity's representative to satisfy any requirement of this section as provided in § 240.15Fh-3(i).**<br><br>(~~b~~**d**) Before initiation of a security-based swap with a special entity, a security-based swap dealer shall disclose to the special entity in writing the capacity in which the security-based swap dealer is acting and, if the security-based swap dealer engages in business~~, or has engaged in business within the last twelve months,~~ with the counterparty | These changes to Rule 15Fh-5(d) would conform the language to the parallel CFTC EBC Rule by deleting the twelve-month "look back" period, which could |

| Recommended Modifications | Discussion |
|---|---|
| in more than one capacity, the security-based swap dealer shall disclose the material differences between such capacities ~~in connection with the security-based swap and any other financial transaction or service involving the counterparty~~.<br><br>(~~c~~**e**) The requirements of this § 240.15Fh-5 shall not apply with respect to a security-based swap **that is intended to be cleared** if:<br><br>(i) The transaction is **(A)** executed on a registered **or exempt** security-based swap execution facility or registered national securities exchange **and (B) of a type that is, as of the date of execution, required to be cleared pursuant to Section 3C of the Act**; ~~and~~**or**<br><br>(ii) The security-based swap dealer does not know the identity of the counterparty, at any time up to and including execution of the transaction. | confuse counterparties as to the nature of their current relationship with an SBS dealer.<br><br>These modifications to the exception for exchange-traded SBS would harmonize the scope of the SEC's special entity advisor requirements with the scope of parallel CFTC requirements under the relief provided by CFTC No-Action Letter 13-70. *See* the discussion accompanying Rule 15Fh-3(b)(4) for a more detailed description of the rationale for these modifications. |
| § 240.15Fh-6 **Political contributions by certain security-based swap dealers.**<br><br>(a) Definitions. For the purposes of this section:<br><br>(1) The term contribution means any gift, subscription, loan, advance, or deposit of money or anything of value made:<br><br>(i) For the purpose of influencing any election for state or local office;<br><br>(ii) For payment of debt incurred in connection with any such election; or<br><br>(iii) For transition or inaugural expenses incurred by the successful candidate for state or local office.<br><br>(2) The term covered associate means:<br><br>(i) Any general partner, managing member or executive officer, or other person with a | |

| Recommended Modifications | Discussion |
| --- | --- |
| similar status or function;<br><br>(ii) Any employee who solicits a municipal entity to enter into a security-based swap with the security-based swap dealer and any person who supervises, directly or indirectly, such employee; and<br><br>(iii) A political action committee controlled by the security-based swap dealer or by a person described in paragraphs (a)(2)(i) and (a)(2)(ii) of this section.<br><br>(3) The term executive officer of a security-based swap dealer means:<br><br>(i) The president;<br><br>(ii) Any vice president in charge of a principal business unit, division or function (such as sales, administration or finance);<br><br>(iii) Any other officer of the security-based swap dealer who performs a policymaking function; or<br><br>(iv) Any other person who performs similar policy-making functions for the security-based swap dealer.<br><br>(4) The term municipal entity is defined in Section 15B(e)(8) of the Act.<br><br>(5) The term official of a municipal entity means any person (including any election committee for such person) who was, at the time of the contribution, an incumbent, candidate or successful candidate for elective office of a municipal entity, if the office:<br><br>(i) Is directly or indirectly responsible for, or can influence the outcome of, the selection of a security-based swap dealer by a municipal entity; or<br><br>(ii) Has authority to appoint any person who is directly or indirectly responsible for, or | |

| Recommended Modifications | Discussion |
| --- | --- |
| can influence the outcome of, the selection of a security-based swap dealer by a municipal entity.<br><br>(6) The term payment means any gift, subscription, loan, advance, or deposit of money or anything of value.<br><br>(7) The term regulated person means:<br><br>(i) A person that is subject to rules of the Commission, the Commodity Futures Trading Commission or a self-regulatory organization subject to the jurisdiction of the Commission or the Commodity Futures Trading Commission prohibiting it from engaging in specified activities if certain political contributions have been made, or its officers or employees;<br><br>(ii) A general partner, managing member or executive officer of such person, or other individual with a similar status or function; or<br><br>(iii) An employee of such person who solicits a municipal entity for the security-based swap dealer and any person who supervises, directly or indirectly, such employee.<br><br>(8) The term solicit means a 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.<br><br>(b) Prohibitions and Exceptions.<br><br>(1) It shall be unlawful for a security-based swap dealer to offer to enter into, or enter into, a security-based swap, or a trading strategy involving a security-based swap, with a municipal entity within two years after any contribution to an official of such municipal entity was made by the security-based swap dealer, or by any covered associate of the security-based swap dealer**, unless such contribution was made before the security-based swap dealer registered with the Commission as such**. | Consistent with CFTC No-Action Letter 12-33, these changes would clarify that the "look back" period does not include any time period before when an SBS dealer is required to register as such. This clarification is necessary to prevent |

| Recommended Modifications | Discussion |
| --- | --- |
| (2) The prohibition in paragraph (b)(1) does not apply:<br><br>(i) If the only contributions made by the security-based swap dealer to an official of such municipal entity were made by a covered associate:<br><br>(A) To officials for whom the covered associate was entitled to vote at the time of the contributions, if the contributions in the aggregate do not exceed $350 to any one official per election; or<br><br>(B) To officials for whom the covered associate was not entitled to vote at the time of the contributions, if the contributions in the aggregate do not exceed $150 to any one official, per election;<br><br>(ii) To a security-based swap dealer as a result of a contribution made by a natural person more than six months prior to becoming a covered associate of the security-based swap dealer, however, this exclusion shall not apply if the natural person, after becoming a covered associate, solicits the municipal entity on behalf of the security-based swap dealer to offer to enter into, or to enter into, security-based swap, or a trading strategy involving a security-based swap; or | retroactive application of the rule during periods before a person knew that it needed to restrict political contributions to municipal entities. |
| (iii) With respect to a security-based swap **(A)** that is ~~initiated~~**executed** by a municipal entity on a registered national securities exchange or registered **or exempt** security-based swap execution facility and **of a type that is, as of the date of execution, required to be cleared pursuant to Section 3C of the Act or (B) if** the security-based swap dealer does not know the identity of the counterparty to the transaction at any time up to and including execution of the transaction.<br><br>(3) No security-based swap dealer or any covered associate of the security-based swap dealer shall:<br><br>(i) Provide or agree to provide, directly or indirectly, payment to any person to solicit a | These modifications to the exception for exchange-traded SBS would harmonize the scope of the SEC's special entity advisor requirements with the scope of parallel CFTC requirements under the relief provided by CFTC No-Action Letter 13-70. *See* the discussion accompanying Rule 15Fh-3(b)(4) for a more detailed description of the rationale for these modifications. |

| Recommended Modifications | Discussion |
| --- | --- |
| municipal entity to offer to enter into, or to enter into, a security-based swap or any trading strategy involving a security-based swap with that security-based swap dealer unless such person is a regulated person; or<br><br>(ii) Coordinate, or solicit any person or political action committee to make, any:<br><br>(A) Contribution to an official of a municipal entity with which the security-based swap dealer is offering to enter into, or has entered into, a security-based swap, or a trading strategy involving a security-based swap; or<br><br>(B) Payment to a political party of a state or locality with which the security-based swap dealer is offering to enter into, or has entered into, a security-based swap security-based swap, or a trading strategy involving a security-based swap.<br><br>(c) Circumvention of Rule. No security-based swap dealer shall, directly or indirectly, through or by any other person or means, do any act that would result in a violation of paragraph ~~(a) or~~ (b) of this section.<br><br>(d) Requests for Exemption. The Commission, upon application, may conditionally or unconditionally exempt a security-based swap dealer from the prohibition under paragraph ~~(a)(1)~~**(b)** of this section. In determining whether to grant an exemption, the Commission will consider, among other factors:<br><br>(1) Whether the exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes of the Act;<br><br>(2) Whether the security-based swap dealer:<br><br>(i) Before the contribution resulting in the prohibition was made, adopted and implemented policies and procedures reasonably designed to prevent violations of this section; | |

| Recommended Modifications | Discussion |
| --- | --- |
| (ii) Prior to or at the time the contribution which resulted in such prohibition was made, had no actual knowledge of the contribution; and<br><br>(iii) After learning of the contribution:<br><br>(A) Has taken all available steps to cause the contributor involved in making the contribution which resulted in such prohibition to obtain a return of the contribution; and<br><br>(B) Has taken such other remedial or preventive measures as may be appropriate under the circumstances;<br><br>(3) Whether, at the time of the contribution, the contributor was a covered associate or otherwise an employee of the security-based swap dealer, or was seeking such employment;<br><br>(4) The timing and amount of the contribution which resulted in the prohibition;<br><br>(5) The nature of the election (e.g., state or local); and<br><br>(6) The contributor's apparent intent or motive in making the contribution that resulted in the prohibition, as evidenced by the facts and circumstances surrounding the contribution.<br><br>(e) Prohibitions Inapplicable.<br><br>(1) The prohibitions under paragraph (b) of this section shall not apply to a contribution made by a covered associate of the security-based swap dealer if:<br><br>(i) The security-based swap dealer discovered the contribution within 120 calendar days of the date of such contribution;<br><br>(ii) The contribution did not exceed $350; and | |

| Recommended Modifications | Discussion |
|---|---|
| (iii) The covered associate obtained a return of the contribution within 60 calendar days of the date of discovery of the contribution by the security-based swap dealer.<br><br>(2) A security-based swap dealer may not rely on paragraph (1) of this section more than twice in any 12-month period.<br><br>(3) A security-based swap dealer may not rely on paragraph (1) of this section more than once for any covered associate, regardless of the time between contributions. | |
| **§ 240.15Fh-7 Prime brokerage arrangements.**<br><br>**(a) Definitions. For purposes of this section:**<br><br>**(1) The term Apportionable Business Conduct Obligations means the obligations of a security-based swap dealer set forth in §§ 240.15Fh-3(a) through (f) and 240.15Fh-4 through 240.15Fh-6.**<br><br>**(2) The term Executing Dealer means a security-based swap dealer that is authorized by a designated Prime Broker to enter into Prime Brokerage Security-Based Swaps with a Prime Broker Client (or its authorized representative), acting as agent for the designated Prime Broker.**<br><br>**(3) The term Prime Broker means a security-based swap dealer that has authorized a Prime Broker Client (or its authorized representative) to enter into Prime Brokerage Security-Based Swaps, as agent for the Prime Broker, with one or more designated Executing Dealers.**<br><br>**(4) The term Prime Broker Client means a security-based swap counterparty that, acting as agent for a designated Prime Broker, either directly or through its authorized representative, is authorized by such Prime Broker to enter into Prime Brokerage Security-Based Swaps with one or more designated Executing Dealers.** | This new rule would, in connection with security-based swaps executed under a prime brokerage arrangement, permit the executing dealer and prime broker to allocate responsibility for compliance with certain external business conduct obligations in a manner consistent with CFTC No-Action Letter 13-11. The SEC staff has similarly permitted the executing broker and prime broker in a securities prime brokerage arrangement to allocate certain responsibilities between themselves in their No-Action Letter of January 25, 1994.<br><br>In a prime brokerage relationship, the prime broker is in the best position to take responsibility for compliance with the external business conduct standards that relate to the general relationship between the SBS dealer and its counterparty, whereas the executing dealer is in the best |

| Recommended Modifications | Discussion |
| --- | --- |
| **(5) The term Prime Broker Client Mirror Security-Based Swap means a security-based swap that is entered into by a Prime Broker and a Prime Broker Client, the terms of which mirror the terms of a related Prime Brokerage Security-Based Swap, subject to associated prime brokerage service fees agreed by the parties.**<br><br>**(6) The term Prime Brokerage Security-Based Swap means a security-based swap that is:**<br><br>**(i) not subject to the clearing requirement of Section 3C of the Act;**<br><br>**(ii) executed by a Prime Broker Client (or its authorized representative), acting as agent for an identified Prime Broker, with an Executing Dealer; and**<br><br>**(iii) subject to the condition subsequent that the Prime Broker is not obligated to perform the security-based swap if its terms fall outside parameters pre-agreed by the Prime Broker, the Executing Dealer and the Prime Broker Client and that, if the security-based swap with the Executing Dealer is accepted or deemed to be accepted by the Prime Broker and a Prime Broker Client Mirror Security-Based Swap would, if entered into, fall within parameters applicable to the Prime Broker Client, obligates the Prime Broker Client (or its authorized representative) and the Prime Broker to execute a Prime Broker Client Mirror Security-Based Swap.**<br><br>**(b) Allocation of Apportionable Business Conduct Obligations. An Executing Dealer and Prime Broker may, with respect to a Prime Broker Client Mirror Security-Based Swap, agree to allocate responsibility for compliance with the Apportionable Business Conduct Obligations if:**<br><br>**(1) All of the Apportionable Business Conduct Obligations are allocated between the Executing Dealer and the Prime Broker;**<br><br>**(2) The Prime Broker Client (or its duly authorized representative) is provided with** | position to take responsibility for compliance with external business conduct standards that are transaction-specific. Unless SBS dealers are permitted to allocate compliance with the external business conduct standards between the prime broker and the executing dealer, it would be impossible to continue existing prime brokerage arrangements. |

| Recommended Modifications | Discussion |
| --- | --- |
| **notice of the allocation of Apportionable Business Conduct Obligations prior to the time at which any such obligation is required to be performed;**<br><br>**(3) The allocation of Apportionable Business Conduct Obligations is in writing and includes an agreement between the Executing Dealer and the Prime Broker that:**<br><br>**(i) Each will perform or otherwise be responsible for each Apportionable Business Conduct Obligation it has agreed to be allocated to it to the full extent of such obligation;**<br><br>**(ii) Each will not be responsible for the compliance of the other with the Apportionable Business Conduct Obligations allocated solely to the other; and**<br><br>**(iii) The Prime Broker Client (or its duly authorized representative) will be provided notice of any expiration or termination of the allocation of Apportionable Business Conduct Obligations no later than 30 days prior to such expiration or termination, and the Executing Dealer and Prime Broker will each remain responsible for fulfilling all applicable Apportionable Business Conduct Obligations allocated to it until such expiration or termination; and**<br><br>**(4) The Executing Dealer and Prime Broker each makes and retains a record of the applicable prime brokerage arrangement, the written allocation of Apportionable Business Conduct Obligations, and the delivery of notice of such written allocation to the Prime Broker Client (if the delivery of such notice shall have been allocated to it) in accordance with §§ 240.17a-4 or 240.18a-6, as applicable, and makes such records available to the Commission upon request.**<br><br>**(c) To the extent that responsibility for compliance with an Apportionable Business Conduct Obligation in connection with a Prime Broker Client Mirror Swap has been allocated to the Executing Dealer in accordance with this section, such Apportionable Business Conduct Obligation shall not apply to the Prime Broker.** | |

| Recommended Modifications | Discussion |
| --- | --- |
| § 240.15Fk-1 **Designation of Chief Compliance Officer for security-based swap dealers and major security-based swap participants.**<br><br>[Reserved.] | We plan to address the SEC's proposed chief compliance officer rule in a later comment letter. |