November 3, 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; Release No. 34-69491

Dear Mr. Fields:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates this opportunity to supplement its earlier letter to the Securities and Exchange Commission (the "**Commission**") dated August 7, 2015 with respect to several aspects of the captioned proposed rulemaking (the "**Proposed Rules**"). In particular, this letter addresses those requirements in the Proposed Rules that security-based swap ("**SBS**") dealers and major SBS participants (together, "**SBS Entities**") would typically satisfy by obtaining written representations from their counterparties. Each of those requirements has a parallel requirement in the external business conduct rules adopted by the Commodity Futures Trading Commission ("**CFTC**") for swap dealers and major swap participants (together, "**Swap Entities**") (the "**CFTC EBC Rules**").[2]

With respect to these requirements, we recommend that the Commission (i) adopt conforming changes to incorporate certain safe harbors contained in the CFTC EBC Rules and (ii) permit SBS Entities, through a negative affirmation process, to rely on existing, swap-related representations as though they were drafted in relation to SBS.

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[1] 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.

[2] 77 Fed. Reg. 9734 (Feb. 17, 2012).

Absent these steps, market participants would need to re-incur the costs and burdens associated with implementing the CFTC EBC Rules even though the differences between the relevant aspects of the Proposed Rules and the CFTC EBC Rules are not material. The reason for this is that the CFTC EBC Rules require Swap Entities to obtain representations that satisfy very precise safe harbors, which were in turn reflected in a multilateral protocol ("**DF Protocol 1.0**")[3] that has been adopted by most market participants.[4] In addition, DF Protocol 1.0 only expressly addresses market participants' trading in swaps, even though the factual matters addressed by the protocol's representations (such as a market participant's status as an eligible contract participant or the qualifications of its representative) typically do not vary as between trading in swaps and trading in SBS.

These costs and burdens would be significant and result in delays before the Proposed Rules could come into effect. In this regard, we note that it took market participants roughly six months to draft DF Protocol 1.0 and over nine additional months to ensure broad, market-wide adherence. During this period, market participants drafted and implemented internal policies and procedures designed to allow them to provide and rely on the representations contained in DF Protocol 1.0. In particular, asset managers making representations on behalf of their clients engaged in extensive diligence regarding those clients, and Swap Entities performed detailed validation processes to reconcile the information they received via DF Protocol 1.0 with their existing books and records.

The Commission could eliminate the need to re-incur these costs, burdens and delays, without compromising the efficacy of the Proposed Rules, by adopting conforming changes and permitting a negative affirmation process as described in this letter. Due to the already extensive similarities between the Proposed Rules and the CFTC EBC Rules, taking these steps would neither materially alter the protections afforded to SBS counterparties nor generally require the Commission to cede interpretive, examination or enforcement responsibility or authority to the CFTC.

Given the absence of material, countervailing considerations, and the very significant cost and time savings that would result, we believe that taking these steps would help the Commission to satisfy the cost-benefit requirements contained in the Securities Exchange Act of 1934 (the "**Exchange Act**").[5] We emphasize, however, that

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[3] *See* https://www2.isda.org/functional-areas/protocol-management/protocol/8. Under DF Protocol 1.0, amendments or supplements to bilateral trading documentation required by the CFTC EBC Rules are effected through delivery of an adherence letter by each party to the underlying document to be amended. Each party that submits an adherence letter must also deliver a completed questionnaire to another protocol participant for the addition of supplemental terms to be effective with respect to that protocol participant.

[4] More than 17,000 entities, which we expect include nearly all of the participants in the U.S. SBS market, have already adhered to DF Protocol 1.0. These entities have submitted 43,962 questionnaires.

[5] *See* Exchange Act Sections 3(f) and 23(a)(2) (requiring the Commission to consider whether its rules "will promote efficiency, competition, and capital formation" and prohibiting the

taking only some of these steps, without taking the others, would still likely result in the need for a new industry-wide documentation initiative.

The specific steps that we recommend are as follows:

Safe Harbor Representations. Although the Proposed Rules and the CFTC EBC Rules cover the same substantive matters, the precise forms of written representations contemplated by the rules differ. Left unchanged, these minor differences would result in the need for another industry-wide documentation initiative. The Commission could avoid this outcome, without binding itself to any future interpretations or rule amendments by the CFTC, by either (i) permitting SBS Entities to reasonably rely on written representations that satisfy the safe harbors contained in the CFTC EBC Rules, as in effect on the date the Commission finalizes the Proposed Rules or (ii) making the clarifications necessary to align the Proposed Rules with those CFTC safe harbors. Below we describe this recommendation in greater detail:

- *Institutional Suitability*. The Proposed Rules and the CFTC EBC Rules each require an SBS dealer or swap dealer, respectively, that makes a recommendation to a non-special entity counterparty to have a reasonable basis to believe that the counterparty, or an agent to which such a counterparty has delegated decision-making authority, is capable of independently evaluating investment risks with regard to the relevant transaction or trading strategy recommended by the dealer.[6]

  Under the CFTC EBC Rules, a swap dealer is deemed to satisfy this requirement if the counterparty represents in writing that it has complied in good faith with written policies and procedures that are reasonably designed to ensure that the persons responsible for evaluating the swap dealer's recommendation and making trading decisions on behalf of the counterparty are capable of doing so.[7] Most non-special entity counterparties have elected to make this representation, which helps ensure that those counterparties conduct appropriate due diligence on their own representatives while avoiding the costs and burdens that would inherently be involved with shifting the responsibility for conducting such diligence to swap dealers who are arm's-length counterparties. Accordingly, we believe the Commission should either (i) permit SBS Entities to reasonably rely on written representations that satisfy this CFTC safe harbor or (ii) adopt a parallel safe harbor.

Commission from adopting any rule that "would impose a burden on competition not necessary or appropriate in furtherance of the purposes" of the Exchange Act).

[6] *See* Proposed Rule 15Fh-3(f)(2)(i) and CFTC Regulations §23.434(b)(1), 17 C.F.R. §23.434(b)(1).

[7] *See* CFTC Regulations §23.434(c)(1), 17 C.F.R. §23.434(c)(1).

- *Non-ERISA Special Entities*. Similar to the institutional suitability safe harbor described immediately above, the CFTC EBC Rules also deem a Swap Entity to have a reasonable basis to believe that a special entity counterparty, which is not an employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974 ("**ERISA**"),[8] has a qualified independent representative if such a non-ERISA special entity and its representative represent in writing regarding their compliance with written policies and procedures designed to comply with applicable qualification and independence requirements.[9]

  Given the similarities between the Commission's proposed qualification and independence requirements and those adopted by the CFTC, and in light of the reduced costs and burdens associated with permitting non-ERISA special entities to follow existing policies and procedures designed to satisfy the CFTC's requirements, we believe the Commission should either (i) permit SBS Entities to reasonably rely on written representations that satisfy the CFTC's safe harbor or (ii) adopt a parallel safe harbor, along with the following modifications to its qualification and independence requirements:

  - Instead of requiring a special entity's representative to provide a special entity with written representations regarding fair pricing and appropriateness, requiring such a representative to evaluate, consistent with any guidelines provided by the special entity, fair pricing and appropriateness. The CFTC adopted this approach

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[8] To address certain ambiguous aspects of the "special entity" definition and align its interpretation of that definition with the CFTC's, the Commission should also clarify that: (i) an instrumentality, department, or a corporation of, or established by, a State or political subdivision of a State is a special entity; (ii) an employee benefit plan that is not subject to Title I of ERISA, such as a church plan, is not a special entity unless elects to be treated as such by notifying an SBS Entity of its election prior to entering into an SBS with the SBS Entity; (iii) master trusts sponsored by one or more employers are considered special entities; (iv) the Commission will not look through a collective investment vehicle to see if it has special entity investors; and (v) a charitable organization will not be treated as a special entity merely by virtue of entering into an SBS for which its counterparty has recourse to the organization's endowment.

[9] Specifically, a Swap Entity is deemed to have a reasonable basis to believe that a non-ERISA special entity has a qualified independent representative if (i) the special entity represents in writing to the Swap Entity that it has complied in good faith with written policies and procedures reasonably designed to ensure that it has selected a representative that satisfied the qualification requirements and that such policies and procedures provide for ongoing monitoring of the performance of such representative consistent with those requirements and (ii) the representative represents in writing to the special entity and the Swap Entity that it (A) has policies and procedures reasonably designed to ensure that it satisfies the qualification requirements, (B) meets the independence test and (C) is legally obligated to comply with the qualification requirements by agreement, condition of employment, law, rule, regulation or other enforceable duty. *See* CFTC Regulation §23.450(d)(1), 17 C.F.R. §23.450(d)(1).

based on comments it received from groups representing special entities, which indicated that requiring transaction-by-transaction representations would materially increase costs for special entities;[10]

- Deeming a special entity's representative not to be subject to a statutory disqualification, for purposes of the Proposed Rules, if the representative is not subject to a statutory disqualification under Section 8a(2) or 8a(3) of the Commodity Exchange Act ("**CEA**"). Although the grounds for statutory disqualification under the Exchange Act and the CEA are not identical, they overlap to a significant extent. As a result, permitting a special entity to rely on existing policies and procedures designed to apply the CEA statutory disqualification test would reduce costs and burdens without materially altering the protections afforded to special entities; and

- Replacing the prong of the Commission's proposed independence requirements that relates to the level of gross revenues received by a special entity's representative from an SBS Entity with requirements for the representative to (i) provide disclosures to the special entity regarding material conflicts of interest that could reasonably affect the representative's judgment or decision-making with respect to its obligations to the special entity and (ii) comply with policies and procedures reasonably designed to manage and mitigate such conflicts of interest.

  These conflicts of interest requirements would ensure that, as is the case under the CFTC EBC Rules, a representative must permit the special entity to assess and mitigate any conflicts of interest that exist between it and the representative, including those relating to the compensation received by the representative.[11] At the same time, unlike the proposed gross revenue prong of the independence requirements, these conflicts of interest requirements would avoid the need for special entities to engage in an extensive data collection and re-documentation effort.[12]

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10 *See, e.g.*, Letter from the American Benefits Council dated Sept. 8, 2010, *available at* http://www.cftc.gov/idc/groups/public/@swaps/documents/dfsubmission/dfsubmission3_090810-abc.pdf.

11 *See* 77 Fed. Reg. 9734, 9795-96 (Feb. 17, 2012).

12 The Commission could also further enhance the independence of a special entity's representative by requiring that an SBS Entity not refer, recommend, or introduce the representative to the special entity within one year of the representative's representation of the special entity in connection with the SBS. *Cf.* CFTC Regulations §23.450(c), 17 C.F.R. §23.450(c).

- *ERISA Special Entities*. The CFTC recognized the unique regime already applicable to employee benefit plans subject to Title I of ERISA, and the standards established by the Department of Labor thereunder, by adopting specific safe harbors for such ERISA special entities. Those safe harbors are based on the Swap Entity receiving written representations regarding an ERISA fiduciary's role in representing the ERISA special entity and evaluating swap-related recommendations.[13] To promote consistency with the CFTC EBC Rules and avoid potential conflicts with ERISA, we believe that the Commission should permit an SBS Entity to rely on these representations for purposes of (i) establishing that it is not an advisor to an ERISA special entity and (ii) having a reasonable basis to believe that an ERISA special entity has a qualified independent representative.

Negative Affirmation. As noted above, the representations contained in DF Protocol 1.0 only expressly address market participants' trading in swaps, but the factual matters addressed by those representations typically do not vary as between trading in swaps and trading in SBS. As a result, requiring SBS Entities to obtain separate representations specifically addressing SBS would impose additional costs with few, if any, additional benefits.

Instead of requiring new, duplicative representations, it would be more efficient if the Commission clarified that an SBS Entity could confirm that an SBS counterparty's existing, swap-related representations also apply to the counterparty's trading in SBS through a negative affirmation procedure. Under this procedure, the SBS Entity would provide the SBS counterparty with a prominent written notice that, unless the counterparty notifies the SBS Entity to the contrary in writing, the SBS Entity will deem written representations made by the counterparty to the SBS Entity (or an affiliate) with respect to the counterparty's trading in swaps also to apply to the counterparty's trading in SBS. The SBS Entity could then rely on those existing representations until and unless the counterparty notified the SBS Entity to the contrary in writing or the SBS Entity became aware of information that would cause a reasonable person either to question

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[13] Specifically, a swap dealer is not considered to act as an advisor to an ERISA special entity if (i) the special entity represents in writing that it has a fiduciary as defined in section 3 of ERISA that is responsible for representing the special entity in connection with the swap transaction, (ii) the fiduciary represents in writing that it will not rely on recommendations provided by the swap dealer, and (iii) the special entity represents in writing that either (A) it will comply in good faith with written policies and procedures designed to ensure that any recommendation the special entity receives from the swap dealer materially affecting a swap transaction is evaluated by a fiduciary before the transaction occurs or (B) any such recommendation will be evaluated by a fiduciary before the transaction occurs. *See* CFTC Regulations §23.440(b)(1), 17 C.F.R. §23.440(b)(1). A Swap Entity is also deemed to have a reasonable basis to believe that an ERISA special entity has a qualified independent representative if the ERISA special entity provides its representative's name and contact information to the Swap Entity and represents in writing that the representative is a fiduciary as defined in section 3 of ERISA. *See* CFTC Regulations §23.450(d)(2), 17 C.F.R. §23.450(d)(2).

whether the representations apply to SBS or to question the accuracy of the representations in some other respect.[14]

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We would be pleased to provide further information or assistance at the request of the Commission 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

[14] We believe that such reliance should be permitted not only in connection with the Proposed Rules, but also in connection with other aspects of the Commission's SBS regulatory regime that require an SBS Entity to ascertain information about a counterparty, if the counterparty has made a written representation about such information in respect of the counterparty's trading in swaps and the information is not reasonably expected to vary as between the counterparty's trading in swaps and its trading in SBS.