

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PARTS 230, 240 and 260**

[Release Nos. 33-9222; 34-64639; 39-2474; File No. S7-22-11]

**RIN 3235-AL16**

**EXEMPTIONS FOR SECURITY-BASED SWAPS ISSUED BY CERTAIN CLEARING AGENCIES**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rules.

**SUMMARY:** We are proposing exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for security-based swaps issued by certain clearing agencies satisfying certain conditions. The proposed rules would exempt transactions by clearing agencies in these security-based swaps from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provisions, as well as exempt these security-based swaps from Exchange Act registration requirements and from the provisions of the Trust Indenture Act, provided certain conditions are met.

**DATES:** Comments on the proposed rules should be received on or before July 25, 2011.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-22-11 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-22-11. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Tamara Brightwell, Senior Special Counsel to the Director, Michael J. Reedich, Special Counsel, Office of Chief Counsel, or Andrew Schoeffler, Special Counsel, Office of Capital Market Trends, Division of Corporation Finance, at (202) 551-3500, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-4561.

**SUPPLEMENTARY INFORMATION:** We are proposing new Rule 239 under the Securities Act of 1933 ("Securities Act").<sup>1</sup> We are also proposing new Rule 12a-10 and an amendment to Rule 12h-1 under the Securities Exchange Act of 1934 ("Exchange Act")<sup>2</sup> and Rule 4d-11 under the Trust Indenture Act of 1939 ("Trust Indenture Act").<sup>3</sup>

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<sup>1</sup> 15 U.S.C. 77a et seq.

<sup>2</sup> 15 U.S.C. 78a et seq.

<sup>3</sup> 15 U.S.C. 77aaa et seq.

## I. BACKGROUND

On July 21, 2010, the President signed the Dodd-Frank Act into law.<sup>4</sup> The Dodd-Frank Act was enacted to, among other purposes, promote the financial stability of the United States by improving accountability and transparency in the financial system.<sup>5</sup> Title VII of the Dodd-Frank Act provides the Securities and Exchange Commission (“SEC” or the “Commission”) and the Commodity Futures Trading Commission (“CFTC”) with the authority to regulate over-the-counter (“OTC”) derivatives in light of the recent financial crisis.

The Dodd-Frank Act provides that the CFTC will regulate “swaps,” the SEC will regulate “security-based swaps,” and the CFTC and SEC will jointly regulate “mixed swaps.”<sup>6</sup> The Dodd-Frank Act amends the Exchange Act to require, among other things, the following: (1) transactions in security-based swaps must be submitted for clearing to a clearing agency if such security-based swap is one that the Commission has determined is required to be cleared, unless an exception from mandatory clearing applies;<sup>7</sup> (2) transactions in security-based swaps must be

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<sup>4</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>5</sup> See Pub. L. No. 111-203, Preamble.

<sup>6</sup> Section 712(d) of the Dodd-Frank Act provides that the Commission and the CFTC, in consultation with the Board of Governors of the Federal Reserve System, shall jointly further define the terms “swap,” “security-based swap,” “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant,” “eligible contract participant,” and “security-based swap agreement.” These terms are defined in Sections 721 and 761 of the Dodd-Frank Act and, with respect to the term “eligible contract participant,” in Section 1a(18) of the Commodity Exchange Act (“CEA”), 7 U.S.C. 1a(18), as re-designated and amended by Section 721 of the Dodd-Frank Act. See Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, Release No. 34-62717 (Aug. 13, 2010), 75 FR 51429 (Aug. 20, 2010) (advance joint notice of proposed rulemaking regarding definitions contained in Title VII of the Dodd-Frank Act); and Product Definitions Contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Release No. 33-9204; 34-64372 (Apr. 29, 2011) 76 F.R. 29818.

<sup>7</sup> See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C).

reported to a registered security-based swap data repository (“SDR”) or the Commission;<sup>8</sup> and (3) if a security-based swap is subject to mandatory clearing, transactions in security-based swaps must be executed on an exchange or a registered or exempt security-based swap execution facility (“security-based SEF”), unless no exchange or security-based SEF makes such security-based swap available for trading or the security-based swap transaction is subject to the clearing exception in Exchange Act Section 3C(g).<sup>9</sup> In this release, we are proposing exemptions from the registration requirements of the Securities Act and the Exchange Act, and from the qualification requirements of the Trust Indenture Act, to facilitate implementation of these new requirements.

We believe that the increased use of central clearing for security-based swaps should help to promote robust risk management, foster greater efficiencies, improve investor protection, and promote transparency in the market for security-based swaps.<sup>10</sup> The Dodd-Frank Act seeks to ensure that, wherever possible and appropriate, security-based swaps are cleared.<sup>11</sup> Paragraph (a)(1) of new Exchange Act Section 3C establishes a mandatory clearing requirement for certain

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<sup>8</sup> See Pub. L. No. 111-203, §§ 763(i) and 766(a) (adding Exchange Act Sections 13(m)(1)(G) and 13A(A)(1), respectively).

<sup>9</sup> See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C). See also Pub. L. No. 111-203, § 761 (adding Exchange Act Section 3(a)(77) (defining the term “security-based swap execution facility”)), and Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-63825 (Feb. 2, 2011) 76 FR 10948 (Feb. 28, 2011).

<sup>10</sup> See Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC, Release No. 34-63107 (Oct. 14, 2010), 75 FR 65881 (Oct. 26, 2010), Section III.A.2.a.

<sup>11</sup> See, e.g., Report of the Senate Committee on Banking, Housing, and Urban Affairs regarding The Restoring American Financial Stability Act of 2010, S. Rep. No. 111-176 at 34 (stating that “[s]ome parts of the OTC market may not be suitable for clearing and exchange trading due to individual business needs of certain users. Those users should retain the ability to engage in customized, uncleared contracts while bringing in as much of the OTC market under the centrally cleared and exchange-traded framework as possible.”).

security-based swaps.<sup>12</sup> Exchange Act Section 3C(b) sets forth a process by which we would determine whether a security-based swap or any group, category, type or class of security-based swap that a clearing agency plans to accept for clearing is required to be cleared.<sup>13</sup> If we make a determination that a security-based swap is required to be cleared, then parties may not engage in such a security-based swap without submitting it for clearing, unless an exception applies.<sup>14</sup> If we make a determination that a security-based swap is not required to be cleared, such security-based swap may still be cleared on a non-mandatory basis by the clearing agency if it has rules that permit it to clear such security-based swap.<sup>15</sup>

Clearing agencies are broadly defined under the Exchange Act and may undertake a variety of functions.<sup>16</sup> One such function is to act as a central counterparty (“CCP”).<sup>17</sup> For

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<sup>12</sup> Section 763(a) of the Dodd-Frank Act added Section 3C to the Exchange Act. See also Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies: Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations, Release No. 34-63557 (Dec. 15, 2010), 75 FR 82490 (Dec. 30, 2010) (“Mandatory Clearing Proposing Release”).

<sup>13</sup> See Exchange Act Section 3C(b) and Mandatory Clearing Proposing Release. In the Mandatory Clearing Proposing Release, we proposed rules to establish processes for (i) clearing agencies registered with the Commission to submit for review each security-based swap, or any group, category, type or class of security-based swaps, that the clearing agency plans to accept for clearing for a determination by the Commission of whether the security-based swap, or group, category, type or class of security-based swap is required to be cleared, and to determine the manner of notice the clearing agency must provide to its members of such submission, and (ii) how the Commission may stay the requirement that a security-based swap is subject to mandatory clearing.

<sup>14</sup> See Exchange Act Section 3C(g) and Mandatory Clearing Proposing Release. Section 3C(g)(1) provides that a security-based swap otherwise subject to mandatory clearing is not required to be cleared if one party to the security-based swap is not a financial entity, is using security-based swaps to hedge or mitigate commercial risk, and notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into non-cleared security-based swaps.

<sup>15</sup> See 15 U.S.C. 78s(b) and 12 U.S.C. 5465(e). See also Mandatory Clearing Proposing Release.

<sup>16</sup> See Exchange Act Section 3(a)(23).

<sup>17</sup> A CCP is an entity that interposes itself between the counterparties to a securities transaction, acting functionally as the buyer to every seller and the seller to every buyer. See Clearing Agency Standards for Operation and Governance, Release No. 34-64017 (Mar. 3, 2011), 76 FR 14472 (Mar. 16, 2011) (“Clearing Agency Standards Proposing Release”).

example, when a security-based swap between two counterparties that are members of a CCP is executed and submitted for clearing, the original contract is extinguished and is replaced by two new contracts where the CCP is the buyer to the seller and the seller to the buyer.<sup>18</sup> At that point, the original counterparties are no longer counterparties to each other. As a result, the creditworthiness and liquidity of the CCP is substituted for the creditworthiness and liquidity of the original counterparties.<sup>19</sup>

Under the rules we recently proposed regarding mandatory clearing, to meet the clearing requirement in Exchange Act Section 3C, the parties would be required to submit security-based swaps required to be cleared to a clearing agency that functions as a CCP for central clearing.<sup>20</sup> The proposed rules also would establish procedures for a clearing agency to submit to us for a review each security-based swap, or group, category, type or class of security-based swap, that the clearing agency plans to accept for clearing. We would review the submission and make a determination about whether the security-based swap, or group, category, type or class of security-based swap, is required to be cleared.<sup>21</sup> Under the statute and the proposed rules, the submission would be publicly available and a public comment period would be provided with respect to whether the clearing requirement will apply.<sup>22</sup>

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<sup>18</sup> “Novation” is a “process through which the original obligation between a buyer and seller is discharged through the substitution of the CCP as seller to buyer and buyer to seller, creating two new contracts.” Committee on Payment and Settlement Systems, Technical Committee of the International Organization of Securities Commissioners, Recommendations for Central Counterparties (November 2004) at 66.

<sup>19</sup> See Cecchetti, Gyntelberg and Hollanders, Central counterparties for over-the-counter derivatives, BIS Quarterly Review, September 2009, available at [http://www.bis.org/publ/qtrpdf/r\\_qt0909f.pdf](http://www.bis.org/publ/qtrpdf/r_qt0909f.pdf).

<sup>20</sup> See Mandatory Clearing Proposing Release and proposed Rule 3Ca-2.

<sup>21</sup> See Mandatory Clearing Proposing Release and Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C).

<sup>22</sup> Id.

If we determine that a security-based swap, or group, category, type, or class of security-based swap is required to be cleared, counterparties would be required to submit such security-based swaps negotiated and entered into bilaterally to the clearing agency for novation.<sup>23</sup> Thus, for security-based swaps submitted for novation, the CCP will be the issuer of new security-based swaps. Because the definition of “security” in the Securities Act was amended in the Dodd-Frank Act to include security-based swaps,<sup>24</sup> the novation of a security-based swap by a clearing agency functioning as a central counterparty involves an offer and sale by the clearing agency of a security (the security-based swap) under the Securities Act.

The Securities Act requires that any offer and sale of a security must either be registered under the Securities Act or made pursuant to an exemption from registration.<sup>25</sup> Certain provisions of the Exchange Act relating to the registration of classes of securities and the indenture qualification provisions of the Trust Indenture Act also potentially would apply to security-based swaps. The provisions of Section 12 of the Exchange Act could, without an exemption, require that security-based swaps be registered before a transaction could be effected on a national securities exchange.<sup>26</sup> In addition, registration of a class of security-based swaps under Section 12(g) would be required if the security-based swap is considered an equity security and there are more than 500 record holders of a particular class of security-based swaps at the

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<sup>23</sup> See Exchange Act Section 3C and proposed Exchange Act Rule 3Ca-2.

<sup>24</sup> See Pub. L. No. 111-203, Section 761(a) (amending Section 3(a) of the Exchange Act).

<sup>25</sup> See Section 5 of the Securities Act [15 U.S.C. 77e].

<sup>26</sup> We note that a registered security-based SEF would not be a national securities exchange for purposes of the Exchange Act. Therefore, Exchange Act Sections 12(a) and (b) would not be applicable to transactions effected through such facilities.

end of a fiscal year. Further, without an exemption, the Trust Indenture Act would require qualification of an indenture for security-based swaps considered to be debt.<sup>27</sup>

The provisions of the Dodd-Frank Act do not contain an exemption from Securities Act or Exchange Act registration, or from Trust Indenture Act qualification, for security-based swaps, and we believe that compliance with the registration and qualification provisions of these Acts likely would be impracticable and frustrate the purposes of the Dodd-Frank Act. We have taken action in the past to facilitate clearing of certain credit default swaps by clearing agencies functioning as CCPs. For example, prior to enactment of the Dodd-Frank Act, we permitted five clearing agencies to clear certain credit default swaps (“eligible CDS”) on a temporary conditional basis.<sup>28</sup> To facilitate the operation of clearing agencies as CCPs for eligible CDS, we

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<sup>27</sup> See 15 U.S.C. § 77aaa *et seq.*

<sup>28</sup> See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request on Behalf of ICE Clear Europe Limited Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009), Order Extending Temporary Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Request on Behalf of ICE Clear Europe, Limited Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010), and Order Extending Temporary Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with Request on Behalf of ICE Clear Europe, Limited Related to Central Clearing of Credit Default Swaps and Request for Comment, Release No. 34-63389 (Nov. 29, 2010), 75 FR 75520 (Dec. 3, 2010); Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request on Behalf of Eurex Clearing AG Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009), Order Extending and Modifying Temporary Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Request on Behalf of Eurex Clearing AG Related to Central Clearing of Credit Default Swaps, and Request for Comment, Release No. 34-61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010), and Order Extending Temporary Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with Request on Behalf of Eurex Clearing, AG Related to Central Clearing of Credit Default Swaps and Request for Comment, Release No. 34-63390 (Nov. 29, 2010), 75 FR 75518 (Dec. 3, 2010); Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With Request of Chicago Mercantile Exchange Inc. and Citadel Investment Group, L.L.C. Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), Order Extending and Modifying Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request of Chicago Mercantile Exchange Inc. Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request of Chicago Mercantile Exchange Inc. Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010), and Order Extending Temporary Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with Request of Chicago Mercantile Exchange Inc. Related to Central Clearing

also adopted interim temporary exemptions from certain provisions of the Securities Act, the Exchange Act and the Trust Indenture Act, subject to certain conditions.<sup>29</sup> In the adopting release, we noted that we believed that the existence of CCPs for CDS would be important in helping to reduce counterparty risks inherent in the CDS market.<sup>30</sup> In addition to those actions with respect to eligible CDS, as discussed further below, the exemptions we are proposing today are similar to exemptions under the Securities Act and the Exchange Act for security futures products and certain standardized options.<sup>31</sup>

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of Credit Default Swaps and Request for Comment, Release No. 34-63388 (Nov. 29, 2010), 75 FR 75522 (Dec. 3, 2010); Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With Request on Behalf of ICE US Trust LLC Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), Order Extending and Modifying Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request from ICE Trust U.S. LLC Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009); Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request of ICE Trust U.S. LLC Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010), and Order Extending and Modifying Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request of ICE Trust U.S. LLC Related to Central Clearing of Credit Default Swaps and Request for Comment, Release No. 34-63387 (Nov. 29, 2010), 75 FR 75502 (Dec. 3, 2010); and Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection with Request of LIFFE Administration and Management and LCH.Clearnet Ltd. Related to Central Clearing Of Credit Default Swaps, and Request for Comments, Release No. 34-59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (collectively, “CDS Clearing Exemption Orders”). LIFFE A&M and LCH.Clearnet Ltd. allowed their order to lapse without seeking renewal.

<sup>29</sup> See Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps, Release No. 33-8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009) (“Temporary CDS Exemptions Release”). The interim final temporary rules exempted eligible credit default swaps from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provisions, the Exchange Act registration requirements, and the provisions of the Trust Indenture Act, provided certain conditions were met.

<sup>30</sup> See id. We extended the expiration date of the final temporary rules until July 16, 2011. See Extension of Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps, Release No. 33-9158 (Nov. 19, 2010), 75 FR 72660 (Nov. 26, 2010).

<sup>31</sup> See Exemption for Standardized Options From Provisions of the Securities Act of 1933 and From the Registration Requirements of the Securities Exchange Act of 1934, Release No. 33-8171 (Dec. 23, 2002), 68 FR 1 (Jan. 2, 2003) (“Standardized Options Release”).

The rules proposed in this release are intended to further the goal of central clearing of security-based swaps by providing exemptions for the issuance of security-based swaps in connection with novation by a registered or exempt clearing agency functioning as a CCP from certain regulatory provisions that might otherwise interfere with such clearing activities. Without an exemption, a clearing agency functioning as a CCP would be required to register the security-based swap transaction, which could unnecessarily impede the central clearing of security-based swaps.<sup>32</sup> In addition, the clearing agency would be subject to Exchange Act registration and reporting requirements, and to the requirements of the Trust Indenture Act. We believe that the proposed exemptions from the Securities Act, Exchange Act, and Trust Indenture Act are necessary to facilitate the intent of the Dodd-Frank Act with respect to mandatory clearing of security-based swaps. As noted above, these proposed exemptions are similar to the exemptions we adopted for eligible CDS and standardized options, as well as the exemptions that are provided in the Securities Act and the Exchange Act for security futures products. In addition to our interest in facilitating clearing of security-based swaps, we believe that security-based swaps can be used for financial purposes similar to those served by standardized options and security futures products, and thus we believe that it is appropriate to establish comparable regulatory treatment for security-based swaps. By doing so, we believe that the proposed exemptions would allow for economically similar regulatory treatment under the Securities Act and Exchange Act.<sup>33</sup>

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<sup>32</sup> In addition, because the novation generally occurs after the counterparties have agreed to enter into the bilateral security-based swap being novated the investment decision by the counterparties already has occurred.

<sup>33</sup> Standardized options and security futures products are only traded on a national securities exchange and thus are subject to listing standards. This differs from the regulatory treatment of security-based swaps under the provisions of the Dodd-Frank Act, which provide that a security-based swap may be cleared by the clearing agency but does not require such security-based swap to be traded on a national securities exchange. We note, however, that security-based swap transactions must be registered under the Securities

## II. DISCUSSION OF THE PROPOSED RULES AND AMENDMENTS

We are proposing rules and amendments to existing rules (collectively, “proposed rules”) to provide certain exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act for security-based swaps issued by clearing agencies functioning as CCPs.

### A. Securities Act Rule 239

We are proposing Securities Act Rule 239 to exempt the offer and sale of security-based swaps that are or will be issued to eligible contract participants by, and in a transaction involving, a clearing agency that is registered under Section 17A of the Exchange Act<sup>34</sup> or exempt from such registration<sup>35</sup> by rule, regulation or order of the Commission (“registered or exempt clearing agency”) in its function as a CCP, from all provisions of the Securities Act, except the anti-fraud provisions of Section 17(a), subject to certain conditions.<sup>36</sup> Thus, proposed Securities Act Rule 239 will permit the offer and sale of security-based swaps to eligible contract participants that are or will be issued by, and in a transaction involving, a registered or exempt

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Act and traded on an exchange if offered or sold to non-eligible contract participants. See Pub. L. No. 111-203 § 768(b) (adding Securities Act Section 5(d)) and Pub. L. No. 111-203 §763(e) (adding Exchange Act Section 6(l)).

<sup>34</sup> Section 763(b) of the Dodd-Frank Act provides that certain security-based swap clearing agencies will be deemed registered as clearing agencies for the purpose of clearing security-based swaps. The deemed registered provision, which becomes effective on July 16, 2011, applies if the entity is: (i) a depository institution that cleared swaps as a multilateral clearing organization before July 21, 2010, or (ii) a derivatives clearing organization registered with the CFTC that cleared swaps pursuant to a clearing agency exemption of the Commission before July 21, 2010. Currently, four security-based swap clearing agencies have temporary conditional exemptions from clearing agency registration under Section 17A solely to perform the functions of a clearing agency for certain CDS. See CDS Clearing Exemption Orders.

<sup>35</sup> The Dodd-Frank Act contains provisions permitting the Commission to provide exemptions from clearing agency registration with respect to security-based swaps in limited instances. See footnote 42 below. The Commission has the authority to, jointly with the CFTC, prescribe regulations regarding mixed swaps as may be necessary to carry out the provisions of Title VII of the Dodd-Frank Act. The proposed rules would cover security-based swaps, including mixed swaps, issued by clearing agencies that the Commission specifically exempts from registration by rule, regulation, or order.

<sup>36</sup> 15 U.S.C. §77q. This exemption is similar to the Securities Act exemptions for standardized options and security futures products. See Securities Act Rule 238 [17 CFR 230.238] and Section 3(a)(14) [15 U.S.C. §77c(a)(14)].

clearing agency in its function as a CCP without requiring compliance with Section 5 of the Securities Act.<sup>37</sup>

For the reasons described below, under the proposed rule, the offer and sale of a security-based swap would be exempt from the provisions of the Securities Act, other than Section 17(a), if the following conditions are satisfied:

- The security-based swap is or will be issued by a clearing agency that is registered with us or exempt from such registration by rule, regulation or order of the Commission;
- The Commission has determined that the security-based swap is required to be cleared or the registered or exempt clearing agency is permitted to clear the security-based swap pursuant to its rules;
- The security-based swap is sold only to an eligible contract participant (as defined in Section 1a(18) of the Commodity Exchange Act) in a transaction involving the

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<sup>37</sup> The proposed exemption for the security-based swap transaction from Securities Act registration would not apply to any securities that may be delivered in settlement or payment of any obligations under the security-based swap (e.g. a physically settled credit default swap). With respect to such securities transactions, the parties to the security-based swap must either be able to rely on another exemption from the registration requirements of the Securities Act or must register such transaction. In evaluating the availability of an exemption from the Securities Act registration requirements, if such a security-based swap may be settled or paid through the delivery of a security, then the transaction in the underlying or referenced security will be considered to occur at the same time as the transaction in the related security-based swap. In this connection, we note that the Dodd-Frank Act amended Section 2(a)(3) of the Securities Act to provide that security-based swaps could not be used by an issuer, its affiliates, or underwriters to circumvent the registration requirements of Securities Act Section 5 with respect to the issuer's securities underlying the security-based swap. As amended, Section 2(a)(3) provides that "[a]ny offer or sale of a security-based swap by or on behalf of the issuer of the securities upon which such security-based swap is based or is referenced, an affiliate of the issuer, or an underwriter, shall constitute a contract for sale of, sale of, offer to for sale, or offer to sell such securities." As a result, such issuer, affiliate, or underwriter would have to comply with the registration requirements of the Securities Act with respect to such underlying or referenced security, unless another exemption from registration was available.

registered or exempt clearing agency in its function as a CCP with respect to the security-based swap;<sup>38</sup> and

- For each security-based swap that would be offered or sold in reliance upon this exemption, the following information is included in an agreement covering the security-based swap the registered or exempt clearing agency provides to, or makes available to, its counterparty or is posted on a publicly available website maintained by the registered or exempt clearing agency:
  - A statement identifying any security, issuer, loan, or narrow-based security index underlying the security-based swap;
  - A statement indicating the security or loan to be delivered (or class of securities or loans), or if cash settled, the security, loan or narrow-based security index (or class of securities or loans) whose value is to be used to determine the amount of the settlement obligation under the security-based swap; and
  - A statement of whether the issuer of any security or loan, each issuer of a security in a narrow-based security index, or each referenced issuer underlying the security-based swap is subject to the reporting requirements of Exchange Act Section 13 or Section 15(d) and, if not subject to such reporting

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<sup>38</sup> Eligible contract participant is defined in CEA Section 1a(18) (as re-designated and amended by Section 721 of the Dodd-Frank Act. See also Pub. L. No. 111-203, § 761(a) (adding Exchange Act Section 3(a)(65), which refers to the definition of eligible contract participant in the CEA. The definition of eligible contract participant contained the CEA (as amended by the Dodd-Frank Act) includes: financial institutions; insurance companies; investment companies; other entities and employee benefit plans; State and local municipal entities; market professionals, such as broker dealers, futures commission merchants, floor brokers, and investment advisors; and natural persons with a specified dollar amount invested on a discretionary basis. For certain of the entities and market professionals, the definition also contains certain conditions relating to the amount of assets or amount of monies invested on a discretionary basis. For a complete description of the definition, see CEA Section 1a(18) and Section 721 of the Dodd-Frank Act.

requirements, whether public information, including financial information, about any such issuer is available and where the information is available.

We believe that the proposed rule exempting offers and sales of such security-based swaps by a registered or exempt clearing agency in its function as a CCP will further the goal in the Dodd-Frank Act of central clearing of security-based swaps. Without exempting the offers and sales of such security-based swaps by a registered or exempt clearing agency in its function as a CCP from the Securities Act (other than Section 17(a)), we believe that a registered or exempt clearing agency may not be able to clear security-based swaps in the manner contemplated by the Dodd-Frank Act and our proposed rules implementing its provisions. Further, we believe that with the above conditions, an exemption from the Securities Act is necessary and appropriate in the public interest and consistent with the protection of investors.<sup>39</sup>

### **Request for Comment**

1. Should we provide an exemption from the provisions of the Securities Act, other than the antifraud provisions of Section 17(a), for the offer and sale of security-based swaps that are or will be issued to eligible contract participants by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP? Why or why not?
2. If we provide an exemption, are the proposed conditions to the exemption appropriate? Why or why not? Are there additional or different conditions that we should impose? Should we require more specificity as to the terms of the security-based swaps?

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<sup>39</sup> We believe that if the conditions to the proposed exemption are satisfied, then the protections provided for in the exemption for security futures arising from the requirement for exchange trading, such as compliance with the statutory listing standards, are not needed here. See Section 6(h) of the Exchange Act [15 U.S.C. 78f(h)]. Unlike security future products that may be purchased by any person, security-based swaps issued by a registered or exempt clearing agency in its function as a CCP may only be entered into by eligible contract participants (unless the security-based swap transaction is on a national securities exchange and there is an effective registration statement under the Securities Act covering transactions in such security-based swap). See Pub. L. No. 111-203, § 763(e) (adding Exchange Act Section 6(l)) and § 768(b) (adding Securities Act Section 5(d)).

## 1. Registered or Exempt Clearing Agency Issuing Security-Based Swaps in its Function as a CCP

The proposed Securities Act exemption would apply only to offers and sales of security-based swaps that are or will be issued by, and in a transaction involving, a clearing agency in its function as a CCP that is either registered with us or exempt from such registration by rule, regulation or order of the Commission. Registered clearing agencies are regulated by us under the Exchange Act and must comply with the standards in Exchange Act Section 17A.<sup>40</sup> The activities of such clearing agencies relating to the clearing or submission for clearing of security-based swaps are subject to regulation under the Exchange Act and applicable rules thereunder.<sup>41</sup> The proposed rule also would be available for security-based swaps that are issued by a clearing agency that we have exempted from registration with us by rule, regulation, or order, subject to such terms and conditions contained in any exemption.<sup>42</sup> We believe it is appropriate to make the proposed Securities Act exemption available to security-based swaps issued by exempt clearing agencies because in granting an exemption the Commission could impose conditions to the availability of the exemption that would provide protection to investors.

The proposed exemption would only apply to the extent the clearing agency will issue or is issuing the security-based swap in its function as a CCP and will apply to transactions

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<sup>40</sup> 15 U.S.C. 78q-1. See also discussion in Mandatory Clearing Proposing Release.

<sup>41</sup> Id.

<sup>42</sup> Section 763(b) of the Dodd-Frank Act amended the Exchange Act and added Section 17(k), which provides that “[t]he Commission may exempt, conditionally or unconditionally, a clearing agency from registration under this section for the clearing of security-based swaps if the Commission determines that the clearing agency is subject to comparable, comprehensive supervision and regulation by the Commodity Futures Trading Commission or the appropriate government authorities in the home country of the agency. Such conditions may include, but are not limited to, requiring that the clearing agency be available for inspection by the commission and make available all information requested by the Commission.” Thus, although we have the authority under the Exchange Act, as amended by the Dodd-Frank Act, to provide exemptions from clearing agency registration, our authority to grant an exemption from registration for clearing agencies that clear security-based swaps is more limited than it is for other clearing agencies.

involving such clearing agency.<sup>43</sup> We note that a clearing agency's role as a CCP and an issuer of security-based swaps is similar to a clearing agency's role with respect to standardized options.<sup>44</sup> We believe that a clearing agency's role as a CCP for security-based swaps, similar to a clearing agency's role with respect to standardized options, is fundamentally different from a conventional issuer that registers transactions in its securities under the Securities Act. For example, the purchaser of a security-based swap does not, except in the most formal sense, make an investment decision regarding the clearing agency.<sup>45</sup> Rather, the security-based swap investment decision is based on the referenced security, loan, narrow-based security index, or issuer. In this circumstance, coupled with the other conditions to the proposed exemption, we do not believe that Securities Act registration of the offer and sale of security-based swaps by a clearing agency in its function as a CCP to eligible contract participants is necessary.

### **Request for Comment**

3. Is the proposed exemption appropriately conditioned on the registered or exempt clearing agency issuing the security-based swap in its function as a CCP? Why or why not? Should there be a distinction between registered and exempt clearing agencies for this purpose?

2. **Security-Based Swaps the Commission Determines are Required to be Cleared or that a Clearing Agency is Permitted to Clear Pursuant to its Rules**

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<sup>43</sup> As we noted above, when functioning as a CCP, a clearing agency's creditworthiness and liquidity are substituted for the creditworthiness and liquidity of the original counterparties. See footnote 19 above and accompanying text.

<sup>44</sup> See Standardized Options Release.

<sup>45</sup> We note, however, that a member or other user of a clearing agency may have an interest in the financial condition of the clearinghouse because the member or user will be relying on the ability of the clearinghouse to meet its obligations with respect to cleared transactions. Registered clearing agencies are required to make their audited financial statements and other information about themselves publicly available. See 15 U.S.C. 78j(b).

We recently proposed rules to implement the provisions of the Dodd-Frank Act regarding mandatory and voluntary clearing of security-based swaps, or groups, categories, or types or classes of security-based swaps.<sup>46</sup> Our proposed rules would establish procedures for a clearing agency to submit for a review the security-based swap, or group, category, type or class of security-based swap, that the clearing agency plans to accept for clearing. As proposed, we would review the submission and make a determination of whether the security-based swap, or group, category, type or class of security-based swap, is required to be cleared.<sup>47</sup>

Consistent with the purposes of the Dodd-Frank Act, our proposed exemption is intended to facilitate clearing of security-based swaps that the Commission determines are subject to mandatory clearing, or that are permitted to be cleared pursuant to the clearing agency's rules. Consequently, under proposed Rule 239, a registered or exempt clearing agency would be entitled to rely on the exemption to issue, in its function as a CCP, security-based swaps that we determine are required to be cleared. In addition, the exemption would be available to a registered or exempt clearing agency issuing a security-based swap, in its function as a CCP, that is not subject to mandatory clearing but is permitted to be cleared pursuant to the clearing agency's rules. The proposed exemption would not be available for security-based swaps issued by a registered or exempt clearing agency in its function as a CCP that are not required to be cleared or permitted by its rules to be cleared.

The Dodd-Frank Act also provides that if a security-based swap is subject to the mandatory clearing requirement, it must be traded on an exchange or a registered or exempt

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<sup>46</sup> See Mandatory Clearing Proposing Release.

<sup>47</sup> See Mandatory Clearing Proposing Release. For those security-based swaps that are submitted and not required to be cleared, the clearing agency in its function as a CCP may still clear those security-based swaps if it is permitted by its rules.

security-based SEF, unless no security-based SEF makes such security-based swap available for trading.<sup>48</sup> Thus, it is possible that a security-based swap could be subject to mandatory clearing without being traded on an exchange or security-based SEF. Proposed Rule 239 would be available for security-based swaps that are subject to the mandatory clearing requirement or are permitted to be cleared pursuant to the clearing agency's rules,<sup>49</sup> regardless of whether such security-based swaps also are traded on a national securities exchange or through a security-based SEF.<sup>50</sup> We believe that if the conditions to the proposed exemption are satisfied, then the protections provided for in the analogous exemption for security futures arising from the requirement for exchange trading, such as compliance with the statutory listing standards, are not needed here. Unlike security future products that may be purchased by any person, under the Dodd-Frank Act security-based swaps may only be offered and sold to eligible contract participants either pursuant to an exemption from the registration requirements of the Securities Act and in transactions not effected on a national securities exchange or in registered offerings effected on a national securities exchange. No offers or sales of security-based swaps may be made to non-eligible contract participants unless there is an effective registration statement under

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<sup>48</sup> Exchange Act Section 3C(h) specifies that transactions in security-based swaps that are subject to the clearing requirement of Exchange Act Section 3C(a)(1) must be executed on an exchange or on a security-based SEF registered with us (or a security-based SEF exempt from registration), unless no exchange or security-based SEF makes the security-based swap available to trade or the security-based swap transaction is subject to the clearing exception in Exchange Act Section 3C(g). See Pub. L. No. 111-203, § 763 (adding Section 3C(h) of the Exchange Act) Exchange Act Section 3D(e) allows the Commission to exempt a security-based SEF from registration if the Commission finds that the security-based SEF is subject to comparable comprehensive supervision and regulation on a consolidated basis by the CFTC.

<sup>49</sup> The exemption would be limited to security-based swaps issued by and in a transaction involving a registered or exempt clearing agency in its function as a CCP.

<sup>50</sup> See Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011). In this regard, we note that a security-based swap may be required or permitted to be cleared, but neither a national securities exchange nor a security-based SEF may make the security-based swap available for trading.

the Securities Act covering transactions in such security-based swap<sup>51</sup> and any security-based swap transaction with a non-eligible contract participant must be effected on a national securities exchange.<sup>52</sup> As a result, security-based swaps issued by a registered or exempt clearing agency in its function as a CCP may only be offered and sold to eligible contract participants, unless there is an effective registration statement and the transaction is on a national securities exchange. Thus, because only eligible contract participants may enter into the security-based swaps not traded on a national securities exchange, we do not believe it is necessary to condition the exemption on whether the security-based swap is traded on a national securities exchange. In addition, including such a provision could frustrate the goals of the provisions of the Dodd-Frank Act because the Dodd-Frank Act did not restrict transactions with eligible contract participants to transactions on national securities exchanges. Consequently, the proposed exemption does not include such a requirement.

### **Request for Comment**

4. Should we condition the availability of the exemption on the security-based swap being subject to the mandatory clearing requirement, or being permitted to be cleared pursuant to the clearing agency's rules, as proposed?
5. Should the exemption be limited to security-based swaps that are subject to the mandatory clearing requirement, and not include those that are permitted to be cleared?
6. Should the exemption be available to security-based swaps that are not traded on an exchange or a security-based SEF, as proposed?

### **3. Sales only to Eligible Contract Participants**

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<sup>51</sup> See Pub. L. No. 111-203, § 768(b) (adding Securities Act Section 5(d)).

<sup>52</sup> See Pub. L. No. 111-203, § 763(e) (adding Exchange Act Section 6(l)).

Under the Dodd-Frank Act, only an eligible contract participant may enter into security-based swaps other than on a national securities exchange.<sup>53</sup> In addition, security-based swaps that are not registered pursuant to the Securities Act can only be sold to eligible contract participants.<sup>54</sup> New Section 5(d) of the Securities Act specifically provides that it is unlawful to offer to buy, purchase, or sell a security-based swap to any person that is not an eligible contract participant, unless the transaction is registered under the Securities Act.<sup>55</sup> Given that Congress determined it is appropriate to limit the availability of registration exemptions under the Securities Act to eligible contract participants, we believe it is appropriate to limit the proposed Securities Act exemption to security-based swaps entered into with eligible contract participants.

### **Request for Comment**

7. Should we limit the Securities Act exemption to transactions with eligible contract participants, as proposed?

#### **4. Disclosures Relating to the Security-Based Swaps**

The proposed rule would require the registered or exempt clearing agency to disclose, either in its agreement regarding the security-based swap or on its publicly available website, certain information with respect to the security-based swap. This information would include the following:

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<sup>53</sup> See also Pub. L. No. 111-203, § 763(e) (adding Exchange Act Section 6(l)).

<sup>54</sup> See Pub. L. No. 111-203, § 768(b) (adding Securities Act Section 5(d)).

<sup>55</sup> See Section 768(b) of the Dodd-Frank Act (adding new Securities Act Section 5(d)) (“Notwithstanding the provisions of section 3 or 4, unless a registration statement meeting the requirements of section 10(a) is in effect as to a security-based swap, it shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell, offer to buy or purchase or sell a security-based swap to any person who is not an eligible contract participant as defined in section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)).”).

- A statement identifying any security, issuer, loan, or narrow-based security index underlying the security-based swap;
- A statement indicating the security or loan to be delivered (or class of securities or loans), or if cash settled, the security, loan, or narrow-based security index (or class of securities or loans) whose value is to be used to determine the amount of the settlement obligation under the security-based swap; and
- A statement of whether the issuer of any security or loan, each issuer of a security in a narrow-based security index, or each referenced issuer underlying the security-based swap is subject to the reporting requirements of Exchange Act Section 13 or Section 15(d) and, if not subject to such reporting requirements, whether public information, including financial information, about any such issuer is available, and, if so, the location where the information is available.

The purpose of the proposed requirement relating to the availability of information is to inform investors about whether there is publicly available information about the issuer of the referenced security or the referenced issuer.<sup>56</sup> We are not proposing to condition the exemption on whether the issuer is subject to Exchange Act reporting or whether there is publicly available financial information about such issuer. As noted above, the proposed exemption for offers and sales of security-based swaps issued by, and in a transaction involving, a registered or exempt clearing

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<sup>56</sup> For issuers that are not subject to Exchange Act reporting requirements, the following are some non-exclusive examples of issuers that may have information publicly available, including financial information about the issuer, or circumstances in which public information about a security may be available: (1) an entity that voluntarily files Exchange Act reports; (2) an entity that makes Securities Act Rule 144(d)(4) information available to any person; (3) a foreign private issuer whose securities are listed outside the United States; (4) a foreign sovereign issuer with outstanding debt; (5) for periods before July 21, 2010 an asset-backed security issued in a registered transaction with publicly available distribution reports (for periods after July 21, 2010, asset-backed issuers will continue to be subject to reporting); and (6) an asset-backed security issued or guaranteed by the Federal National Mortgage Association (“Fannie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”) or the Government National Mortgage Association (“Ginnie Mae”).

agency in its function as a CCP would be limited to security-based swaps entered into with an eligible contract participant. The Dodd-Frank Act did not restrict eligible contract participants' ability to enter into security-based swaps based on whether or not there is publicly-available information about the issuer of the referenced security or loan or the referenced issuer.<sup>57</sup> As a result, and in light of the nature of the other regulatory safeguards,<sup>58</sup> we are not proposing to condition the proposed exemption on the actual availability or delivery of such information. While the Dodd-Frank Act does not condition clearing of security-based swaps on the availability of such information, we believe it is important for eligible contract participants to understand whether such information is publicly available. The availability (or absence) of public information is generally important to eligible contract participants and the registered or exempt clearing agency in evaluating and pricing the security-based swap. Therefore, our proposed rule would require disclosure about whether such information is available.

If the issuer of the referenced security or loan or the referenced issuer is not subject to Exchange Act reporting, but there is publicly available information about the issuer, the clearing agency would be required under the proposal to disclose that fact and disclose where the

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<sup>57</sup> We note that eligible contract participants may enter into security-based swaps on a bilateral basis in reliance on an available exemption from the registration requirements of the Securities Act. The proposed exemption in this release to facilitate clearing of security-based swaps does not apply to these bilateral transactions.

<sup>58</sup> As part of the process for submitting security-based swaps to us for a determination of whether such security-based swaps are subject to mandatory clearing, the Dodd-Frank Act requires us to take into account several factors, such as the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data, when reviewing a submission to clear security-based swaps by a clearing agency. Much of the information that the registered or exempt clearing agency will be required to include in its agreement or on its website, as a condition to the proposed exemption, likely will already be included in the description of the security-based swaps that the clearing agency identifies publicly that it is going to clear. In addition to the security-based swap submission provisions, the Dodd-Frank Act and the rules proposed under the Act relating to reporting requirements, trade acknowledgments and verification, and business conduct would require certain disclosures relating to security-based swaps, some of which would overlap with the information requirement we are proposing. See, e.g., Mandatory Clearing Proposing Release and Trade Acknowledgment and Verification of Security-Based Swap Transactions, Release No. 34-63727 (Jan. 14, 2011), 76 FR 3859 (Jan. 21, 2011) (“Trade Acknowledgement and Verification Proposing Release”).

information is available. This disclosure could include, for example, a statement that the issuer is listed on a particular foreign exchange and where information about issuers on such exchange can be found.

Under our proposal, the required information could be provided in the agreement covering the security-based swap the registered or exempt clearing agency provides or makes available to the counterparty or on a publicly available website maintained by the clearing agency. We understand that master agreements and related schedules for security-based swaps generally contain detailed information about the terms of the security-based swaps.<sup>59</sup> In addition, each registered clearing agency is required to post and maintain a current and complete version of its rules on its website. Thus, we believe that parties engaging in security-based swaps transactions would be familiar with looking to the agreements or a clearing agency's website to obtain information. Given that clearing agencies generally provide information in agreements and maintain publicly available websites, we believe that providing the information we are proposing be required to be disclosed in the agreement for the security-based swap or on the

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<sup>59</sup> In addition, under the rules proposed in the Trade Acknowledgement and Verification Proposing Release and Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, Release No. 63346 (Nov. 19, 2010), 75 FR 75207 (Dec. 2, 2010) (“SBSR Proposing Release”), which were proposed under the Dodd-Frank Act and for which action has not yet been taken with respect to final rules, the information that would be required to be reported to the security-based swap data repository includes the basic terms of the security-based swap: the asset class of the security-based swap, identification of the security-based swap instrument and the specific asset(s) or issuer of a security on which the security-based swap is based; the notional amount(s), and the currenc(ies) in which the notional amount(s) is expressed; the date and time of execution, and the effective date and scheduled termination date; the price; the terms of any fixed or floating rate payments, and the frequency of any payments; the amount(s) and currenc(ies) of any up-front payment(s) and a description of the terms and contingencies of the payment streams of each counterparty to the other; the title of any master agreement, or any other agreement governing the transaction (including the title of any document governing the satisfaction of margin obligations), incorporated by reference and the date of any such agreement; and the data elements necessary for a person to determine the market value of the transaction. To the extent we adopt these or similar information reporting requirements, the parties to the security-based swap transaction would have to know detailed information about the terms of the security-based swap transaction to comply with the reporting requirements.

clearing agency's publicly available website would not pose significant burdens for clearing agencies.

**Request for Comment**

8. Should we require a registered or exempt clearing agency to provide or make available information about the security-based swap it will issue, as proposed?
9. Is the proposed requirement that a registered or exempt clearing agency indicate whether there is public information available about the referenced issuer or security upon which the security-based swap is based appropriate? If not, why not?
10. Should we require a registered or exempt clearing agency to provide or make available any additional or different information? Are any of the proposed disclosures unnecessary?
11. Should the exemption be limited to circumstances where the security-based swap relates to an Exchange Act reporting issuer?
12. Should we require, as proposed, that if the issuer is not an Exchange Act reporting company but there is publicly available information, that the location of that information be disclosed?
13. Should we provide the alternatives of including the disclosure in the agreement covering the security-based swap or on the clearing agency's publicly available website, as proposed? Should we require that all agreements include the information, or, alternatively, require the information to be posted on the clearing agency's publicly available website in any case? As another alternative, should we require that the information be made available to clearing members and eligible contract participants rather than require that the information be publicly available? Will the registered or

exempt clearing agency already provide some or all of the proposed disclosures on its website? If so, what information? Is the information proposed to be required to be provided publicly available from sources other than the registered or exempt clearing agency? If so, where?

**B. Exchange Act Rule 12a-10 and Rule 12h-1(h)**

Section 12(a) of the Exchange Act makes it unlawful for any broker or dealer to effect a transaction in a non-exempt security on a national securities exchange unless the security has been registered under Section 12(b) for trading on that exchange. Section 12(g)(1), as modified by rule, requires any issuer with more than \$10,000,000 in total assets and a class of equity securities held by 500 or more persons to register such security with us.<sup>60</sup>

Rule 12b-1 under the Exchange Act prescribes the procedures for registration under both Section 12(b) and Section 12(g). Absent an exemption, security-based swaps that will be traded on national securities exchanges would be required to be registered under Section 12(b) of the Exchange Act. A registered or exempt clearing agency issuing a security-based swap as a result of novation would be required, without an available exemption, to register the security-based swaps under Section 12(b) before such security-based swaps could be traded on a national securities exchange. In addition, if the security-based swaps were considered equity securities of the registered or exempt clearing agency, the registration provisions of Section 12(g) of the Exchange Act could apply.

As noted above, just as a registered or exempt clearing agency is different from a conventional issuer that registers transactions in its securities under the Securities Act, it is also different with respect to registering a class of its securities, in this case the security-based swap

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<sup>60</sup> 15 U.S.C. 78l(g) and Rule 12g-1 (17 CFR 240.12g-1).

issued by the registered or exempt clearing agency, under the Exchange Act. Therefore, we are proposing two rules relating to Exchange Act registration of security-based swaps that are or have been issued by a registered or exempt clearing agency in its function as a CCP.

We are proposing new Exchange Act Rule 12a-10 to exempt security-based swaps that are or have been issued by a registered or exempt clearing agency in reliance on the proposed exemption under the Securities Act from Section 12(a) of the Exchange Act under certain conditions.<sup>61</sup> Specifically, proposed Exchange Act Rule 12a-10 would provide that Exchange Act Section 12(a) does not apply to any security-based swap that:

- is or will be issued by a registered or exempt clearing agency in its function as a CCP with respect to the security-based swap;
- the Commission has determined is required to be cleared, or that the clearing agency is permitted to clear pursuant to its rules;
- is sold to an eligible contract participant in reliance on Securities Act Rule 239; and
- is traded on a national securities exchange registered pursuant to Section 6(a) of the Exchange Act.

We also are proposing an amendment to Exchange Act Rule 12h-1 to exempt security-based swaps that are or have been issued by a registered or exempt clearing agency from the provisions of Section 12(g) of the Exchange Act under certain conditions.<sup>62</sup> Proposed Exchange Act Rule 12h-1(h) would exempt from Section 12(g) of the Exchange Act security-based swaps that are issued by a registered or exempt clearing agency in its function as a CCP, whether or not such security-based swap is traded on a national securities exchange registered pursuant to

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<sup>61</sup> 15 U.S.C. 78l(a).

<sup>62</sup> 15 U.S.C. 78l(g).

Section 6(a) of the Exchange Act or a registered or exempt security-based SEF.<sup>63</sup> In addition, the security-based swaps being issued by the registered or exempt clearing agency in its function as a CCP must be required to be cleared, or be permitted to be cleared pursuant to the clearing agency's rules, and may only be sold to eligible contract participants.

As we noted in the discussion of the proposed Securities Act exemption, we believe the interest of investors in the security-based swap is primarily with respect to the referenced security or loan, referenced issuer or referenced narrow-based security index, and not with respect to the registered or exempt clearing agency functioning as the CCP.<sup>64</sup> Therefore, we preliminarily believe that requiring clearing agencies to register security-based swaps under the Exchange Act would not provide additional useful information or meaningful protection to investors with respect to the security-based swap. In addition, the other consequences of Exchange Act registration, such as requirements for ongoing periodic reporting and application of the proxy rules to the clearing agency, would not be meaningful in the context of security-based swaps. At the same time, requiring such registration likely would impose burdens on clearing agencies issuing security-based swaps.<sup>65</sup> Therefore, we believe that subjecting the registered or exempt clearing agency to the requirements of the Exchange Act arising from Section 12(a) or 12(g) is not necessary or appropriate in the public interest.

In addition, we note that similar Exchange Act exemptions exist for standardized options issued by a registered options clearing agency and security futures products issued by a

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<sup>63</sup> Exchange Act Rules 12h-1(d) and 12h-1(e) provide similar exemptions for options and futures, respectively.

<sup>64</sup> As noted above, a member or other user of the clearing agency may have an interest in the financial condition of the clearinghouse.

<sup>65</sup> See Pub. L. No. 111-203 § 763(b).

registered or exempt clearing agency.<sup>66</sup> We believe that it is appropriate to establish comparable regulatory treatment for security-based swaps issued by a registered or exempt clearing agency with respect to the applicability of Section 12 of the Exchange Act to security-based swaps issued by a registered or exempt clearing agency. Moreover, we believe it is important to further the goal of facilitating clearing of security-based swaps while maintaining appropriate investor protection.

Security-based swaps that will not be cleared by a registered or exempt clearing agency in its function as a CCP but are listed for trading on a national securities exchange or registered or exempt security-based SEF will not be able to rely on the proposed exemption from registration under Section 12(b) or Section 12(g) of the Exchange Act.<sup>67</sup>

### **Request for Comment**

14. Should we provide an exemption, as proposed, from Section 12(a) and Section 12(g) of the Exchange Act for security-based swaps that are or have been issued to eligible contract participants by a registered or exempt clearing agency in its function as a CCP? Why or why not?

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<sup>66</sup> See Exchange Act Section 12(a) [15 U.S.C. 78l(a)] and Exchange Act Rule 12a-9 [17 CFR 240.12a-9] and Rules 12h-1(d) and (e) [17 CFR 240.12h-1(d) and (e)].

<sup>67</sup> We recognize that security-based swaps that will be issued by a clearing agency, as well as security-based swaps that will not be cleared, may be traded on or through a national securities exchange or a security-based SEF. If the national securities exchange or security-based SEF is acting only in its capacity as a system or platform for trading securities, we do not believe it would be offering or selling the security-based swaps that are being traded or transacted by market participants on or through its system or platform, for purposes of either the Securities Act or the Exchange Act registration provisions applicable to security-based swaps. If the security-based swap being traded on or through the national securities exchange or security-based SEF will, by its terms, be cleared by a clearing agency in its function as a CCP, the security-based swap will be issued by such clearing agency, similar to standardized options and security-future products that are traded on national securities exchanges and cleared by registered clearing agencies. For a security-based swap that will not, by its terms, be cleared by a clearing agency in its function as a CCP, market participants must evaluate the availability of exemptions under the Securities Act and the Exchange Act for their security-based swap transactions.

15. If we should provide an exemption, are the proposed conditions to the exemption appropriate? Why or why not? Are there additional conditions that we should impose?
16. Should we provide an exemption from Section 12(a) and Section 12(g) of the Exchange Act for security-based swaps traded on a national securities exchange but that are not cleared? Why or why not?
17. Should we provide an exemption from Section 12(g) of the Exchange Act for security-based swaps traded on a registered or exempt security-based SEF but that are not cleared? Why or why not?

### **C. Implications of Security-Based Swaps as Securities**

Transactions involving the offer and sale of security-based swaps that are not issued by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP would not be able to rely on the proposed exemptions under the Securities Act and Exchange Act. Thus, the proposed exemptions would not be available for transactions involving security-based swaps that will not be cleared (“uncleared security-based swaps”) that may be entered into on organized markets, such as a security-based SEF or a national securities exchange. It is our understanding that transactions involving uncleared security-based swaps occur today on organized platforms that would likely register as security-based SEFs, and we expect this activity will continue after the effective date of the Dodd-Frank Act.<sup>68</sup> As of the effective date of the Dodd-Frank Act, however, such security-based swaps will be included in the definition of security under the Securities Act and the Exchange Act and subject to the full panoply of the federal securities laws, including the registration requirements of Section 5 of the Securities Act and Section 12 of the Exchange Act. Because the proposed exemptions are limited to security-

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<sup>68</sup> See Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011) (proposed rules relating to security-based SEFs would allow for transactions in uncleared security-based swaps to occur on registered security-based SEFs).

based swaps that are issued or will be issued by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP, counterparties engaging in an uncleared security-based swap would have to either rely on other available exemptions from the registration requirements of the Securities Act, the Exchange Act, and, if applicable, the Trust Indenture Act or consider whether to register such transaction or class of security.

**Request for Comment**

18. How will the proposed exemptions affect, if at all, the manner in which security-based swaps are transacted today and are expected to be transacted once the provisions of Title VII of the Dodd-Frank Act become effective?
19. Will the counterparties to uncleared security-based swaps be able to rely on other available exemptions from registration under the Securities Act and Exchange Act? If not, why? Is further guidance or rules needed in this regard? If so, what type of guidance or rules would be helpful?
20. Are security-based swaps transacted today or expected to be transacted once the provisions of Title VII of the Dodd-Frank Act become effective in a manner that would not permit the parties to rely on existing exemptions under the Securities Act and Exchange Act? If so, please explain in detail why existing exemptions would not be available.
21. Should we consider additional exemptions under the Securities Act and Exchange Act for security-based swaps traded on a national securities exchange or security-based SEFs with eligible contract participants but that are not cleared? Should an exemption from Exchange Act registration be provided if all holders of the class of security-based swap

are eligible contract participants? Why or why not? What conditions to any such exemption would be appropriate, if any?

22. Should we consider providing an exemption under the Securities Act that would allow a public offering of security-based swaps to eligible contract participants on a registered security-based SEF or national securities exchange? Why or why not? What conditions to any such exemption would be appropriate, if any?

**D. Trust Indenture Act Rule 4d-11**

We are proposing Rule 4d-11 under Section 304(d) of the Trust Indenture Act that would exempt any security-based swap offered and sold in reliance on Securities Act Rule 239 from having to comply with the provisions of the Trust Indenture Act.<sup>69</sup> We adopted a similar exemption on a temporary basis for eligible CDS.<sup>70</sup>

The Trust Indenture Act is aimed at addressing problems that unregulated debt offerings posed for investors and the public,<sup>71</sup> and provides a mechanism for debtholders to protect and enforce their rights with respect to the debt. We do not believe that the protections contained in the Trust Indenture Act are needed to protect eligible contract participants to whom a sale of a security-based swap is made in reliance on proposed Securities Act Rule 239. The identified problems that the Trust Indenture Act is intended to address generally do not occur in the offer

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<sup>69</sup> The Trust Indenture Act applies to debt securities sold through the use of the mails or interstate commerce. Section 304 of the Trust Indenture Act exempts from the Trust Indenture Act a number of securities and transactions. Section 304(a) of the Trust Indenture Act exempts securities that are exempt under Securities Act Section 3(a) but does not exempt from the Trust Indenture Act securities that are exempt by Commission rule. Accordingly, while proposed Securities Act Rule 239 would exempt the offer and sale of security-based swaps satisfying certain conditions from all the provisions of the Securities Act (other than Section 17(a)), the Trust Indenture Act would continue to apply absent proposed Rule 4d-11.

<sup>70</sup> See Rule 4d-11T [17 CFR 260.4d-11T].

<sup>71</sup> See 15 U.S.C.77bbb(a).

and sale of security-based swaps.<sup>72</sup> For example, security-based swaps are contracts between two parties and, as a result, do not raise the same problem regarding the ability of parties to enforce their rights under the instruments as would, for example, a debt offering to the public. Moreover, through novation, the clearing agency functionally becomes the counterparty to the buyer and the seller, and, in the case where buyer and seller are both members of the CCP, each would look directly to the clearing agency to satisfy the obligations under the security-based swap. As a consequence, enforcement of contractual rights and obligations under the security-based swap would occur directly between such parties, and the Trust Indenture Act provisions would not provide any additional meaningful substantive or procedural protections.

Accordingly, due to the nature of security-based swaps as contracts that will be or have been issued by a registered or exempt clearing agency in its function as a CCP, we do not believe the protections contained in the Trust Indenture Act are needed with respect to these instruments. Therefore, we believe the proposed exemption is necessary or appropriate in the public interest, consistent with the protection of investors and the purposes fairly intended by the Trust Indenture Act.

### **Request for Comment**

23. The proposed rules include an exemption from the application of the Trust Indenture Act for security-based swaps that are offered and sold in reliance on proposed Securities Act Rule 239. Is this exemption appropriate or are there contractual protections in the Trust Indenture Act that should be included as mandatory provisions of a security-based swap contract that is or will be issued by a registered or exempt clearing agency? If yes, please explain in detail.

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<sup>72</sup> 15 U.S.C. 77bbb(a).

## **E. Transition Matters**

As we discuss above, we adopted temporary rules to exempt eligible credit default swaps from all provisions of the Securities Act (other than the Section 17(a) anti-fraud provisions), Exchange Act registration requirements, and the provisions of the Trust Indenture Act, provided certain conditions were met.<sup>73</sup> We subsequently extended the expiration date of the temporary rules until July 16, 2011.<sup>74</sup> The rules proposed in this release would create permanent exemptions that would supplant the temporary rules. However, the current termination date for the temporary rules may pass before the rules proposed in this release are adopted. We plan to provide an appropriate transition from the temporary rules to any permanent rules. In the event the permanent rules are not in place by July 16, 2011, we may consider extending the temporary rules in order to continue facilitating the clearing of certain credit default swaps by clearing agencies functioning as CCPs.

## **III. GENERAL REQUEST FOR COMMENT**

We request and encourage any interested person to submit comments regarding the proposed rules. In particular, we solicit comment on the following questions:

24. We are interested in understanding what type of security-based swaps would not be eligible for these proposed exemptions. We noted above that the proposed exemptions would not be available for transactions involving uncleared security-based swaps that may be entered into on organized markets, such as a security-based SEF or a national securities exchange. Are there other security-based swaps that would not be

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<sup>73</sup> See Temporary CDS Exemptions Release.

<sup>74</sup> See footnote 30 above.

encompassed within the scope of the proposed exemptions? Should these other security-based swaps be covered by the proposed exemptions? If so, why?

25. What are the amounts and types of security-based swaps that may not satisfy the conditions for the proposed exemptions?
26. We have not proposed an amendment to Securities Act Rule 146 for security-based swaps transactions because the Dodd-Frank Act provides that states may not regulate these transactions (except under their general antifraud authority).<sup>75</sup> Therefore, we do not believe it is necessary to propose that eligible contract participants that are sold security-based swaps in reliance on proposed Securities Act Rule 239 be defined as “qualified purchasers” under Section 18(b)(3) of the Securities Act. Were we to add such a definition, such security-based swaps that are or will be issued by a registered or exempt clearing agency would be included as “covered securities” under Section 18 of the Securities Act and exempt from state securities registration (“blue sky”) laws. Would defining eligible contract participants that are sold security-based swaps pursuant to Securities Act Rule 239 as “qualified purchasers” for purposes of Section 18 of the Securities Act (and thus making the security-based swaps that are or will be issued by a registered or exempt clearing agency “covered securities,”) provide any benefit or greater certainty than that provided by the language in Exchange Act Section 28(a)(4)?
27. The conditions of the proposed Exchange Act and Trust Indenture Act exemptions are the same as the conditions to the proposed Securities Act exemption. Is this appropriate or should there be different conditions relating to the Exchange Act and Trust Indenture Act exemptions? If yes, please explain.

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<sup>75</sup> Exchange Act Section 28(a)(4) (added by Section 767 of the Dodd-Frank Act).

28. Are there transition issues we should consider relating to the temporary rules for eligible CDS and the proposed permanent rules?

#### **IV. PAPERWORK REDUCTION ACT**

##### **A. Background**

Certain provisions of proposed Securities Act Rule 239 would result in “collection of information requirements” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).<sup>76</sup> The Commission is submitting proposed Rule 239 to the Office of Management and Budget (“OMB”) for review in accordance with the PRA.<sup>77</sup> An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The title for this collection of information is:

- “Rule 239” (a proposed new collection of information).

Rule 239 is a newly proposed collection of information under the Securities Act. This new collection of information relates to the proposed information requirements for clearing agencies seeking to rely on the proposed exemption. There is no mandatory retention period for the information disclosed, and the information disclosed would be made publicly available on the clearing agency’s website or in an agreement the clearing agency provides or makes available to its counterparty to the security-based swap transaction. The collection of information would be mandatory and it would not be kept confidential.

##### **B. Summary of Collection of Information**

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<sup>76</sup> 44 U.S.C. 3501 et seq.

<sup>77</sup> Although we are proposing additional rule amendments, we do not anticipate burdens or costs associated with those rules for purposes of the PRA because eligibility for those rules will be dependent on reliance on proposed Rule 239.

As discussed above, one condition to the availability of the exemption provided in proposed Securities Act Rule 239 for offers and sales of security-based swaps issued by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP is that such registered or exempt clearing agency has an agreement covering the security-based swap that is provided or made available to its counterparty or a publicly available website maintained by the registered or exempt clearing agency that contains the following:

- A statement identifying any security, issuer, loan, or narrow-based security index underlying the security-based swap;
- A statement indicating the security or loan to be delivered (or class of securities or loans), or if cash settled, the security, loan or narrow-based security index (or class of securities or loans) whose value is to be used to determine the amount of the settlement obligation under the security-based swap; and
- A statement of whether the issuer of any security or loan, each issuer of a security in a narrow-based security index, or each referenced issuer underlying the security-based swap is subject to the reporting requirements of Exchange Act Section 13 or Section 15(d) and, if not subject to such reporting requirements, whether public information, including financial information, about any such issuer is available and where the information is available.

The other provisions of proposed Rule 239 and other rules we are proposing relate to exemptions and eligibility requirements for those exemptions; therefore, we do not expect that those other provisions would create any new filing, reporting, recordkeeping, or disclosure requirement for registered or exempt clearing agencies.

### **C. Paperwork Reduction Act Burden Estimates**

For purposes of the Paperwork Reduction Act, we estimate that there will be an annual incremental increase in the paperwork burden for clearing agencies as issuers of security-based swaps to comply with our proposed collection of information requirements. The disclosure provisions of proposed Rule 239 would apply to registered or exempt clearing agencies relying on the proposed exemption from the registration requirements of the Securities Act of 1933. The disclosure provisions of the proposed rule would make certain information about security-based swaps that may be cleared by the registered or exempt clearing agency available to eligible contract participants and other market participants.

Currently, four clearing agencies are authorized to clear credit default swaps, which include security-based swaps,<sup>78</sup> pursuant to temporary conditional exemptions under Exchange Act Section 36.<sup>79</sup> The obligation to centrally clear certain security-based swap transactions is a new requirement under Title VII of the Dodd-Frank Act, and we anticipate that clearing agencies operating under temporary conditional exemptions will register or will be deemed registered as clearing agencies eligible to clear security-based swaps.<sup>80</sup> Based on the fact that there are currently four clearing agencies authorized to clear security-based swaps and that there could conceivably be a few more in the foreseeable future,<sup>81</sup> we preliminarily estimate that four to six clearing agencies may plan to centrally clear security-based swaps and seek to rely on the

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<sup>78</sup> These clearing agencies are ICE Trust, CME, ICE Clear Europe, and Eurex. The Commission authorized five entities to clear credit default swaps. See CDS Clearing Exemption Orders. LIFFE A&M and LCH.Clearnet Ltd. allowed their order to lapse without seeking renewal.

<sup>79</sup> 15 U.S.C. 78mm. Of the four clearing agencies granted temporary exemptions from registration, only three have cleared products that likely are classified as security-based swaps under Title VII of the Dodd-Frank Act.

<sup>80</sup> See Pub. L. No. 111-203, § 763(b).

<sup>81</sup> We do not expect there to be a large number of clearing agencies that clear security-based swaps, based on the significant level of capital and other financial resources necessary for the formation of a clearing agency.

proposed exemptions, and therefore, would be subject to the collection of information. For purposes of the PRA, we estimate six clearing agencies would seek to rely on the proposed exemptions.

We preliminarily believe that a registered or exempt clearing agency issuing security-based swaps in its function as a CCP could incur some costs associated with disclosing, or providing or making available, certain information in accordance with proposed Rule 239, either in its agreement regarding the security-based swap or on its publicly available website, with respect to the security-based swap. A clearing agency also could incur costs associated with updating the information on its website or in its agreements, if necessary. The purpose of the proposed requirement is to inform investors about whether there is publicly available information about the issuer of the referenced security or referenced issuer and we believe that a clearing agency likely already would be collecting and making public the type of information required by the proposed rule.<sup>82</sup>

We preliminarily estimate that each registered or exempt clearing agency issuing security-based swaps in its function as a CCP will spend approximately 2 hours each time it provides or updates the information in its agreements relating to security-based swaps or on its website.<sup>83</sup> We estimate that each registered or exempt clearing agency will provide or update the

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<sup>82</sup> As noted above, we proposed rules in the Mandatory Clearing Proposing Release and the SBSR Proposing Release that would require some of the same information as the requirements proposed here (e.g., information relating to the identity of the security or issuer underlying the security-based swap). Although the proposed information requirements also may be required to be made public by the registered or exempt clearing agencies by these other proposed rules, we are calculating the PRA burden for each process individually without accounting for any reduction due to the anticipated overlap. We have decided to calculate the burdens in this manner in order to provide a conservative estimate.

<sup>83</sup> In the Mandatory Clearing Proposing Release, we estimated that four hours would be required by a clearing agency to post a security-based swap submission on its website to comply with proposed Rule 19b-4(o)(5). We believe that the information that would be required to rely on the exemptions proposed in this release is less extensive than the information that would be required in a security-based swap submission. Therefore, we estimate that the burden to include the information that would be required to rely on the proposed

information 20 times per year.<sup>84</sup> Therefore, we preliminarily estimate that the total annual reporting burden for clearing agencies to provide the information in their agreements relating to security-based swaps or on their website to comply with proposed Rule 239(c) will be 240 hours (20 x 2 hours x 6 respondents). We estimate that 75% of the burden of preparation is carried by the clearing agency internally and that 25% of the burden is carried by outside professionals retained by the clearing agency at an average cost of \$400 per hour. We request comment on all of the above estimates.

#### **D. Recordkeeping Requirements**

There is no recordkeeping requirement associated with proposed Rule 239.

#### **E. Request for Comment**

Pursuant to 44 U.S.C. § 3506(c)(2), we request comments in order to evaluate:

- whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information would have practical utility;
- the accuracy of our estimate of the burden of the proposed collection of information;
- whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and

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exemptions in an agreement or on the clearing agency's website would be less than the burden to post a security-based swap submission.

<sup>84</sup> In the Mandatory Clearing Proposing Release, we estimated that each clearing agency will submit 20 security-based swap submissions annually. Thus, we are using that estimate as the basis for our estimate as to how many times per year a clearing agency would be required to provide the information in reliance on the proposed exemptions.

- whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens.

The Commission requests comment on all aspects of its burden estimates. In particular, we request comment on the following:

1. Is the proposed collection of information important for eligible contract participants and other market participants?
2. How many entities would incur collection of information burdens pursuant to Rule 239?
3. Should the estimates be different depending on whether a clearing agency chooses to include information required to rely on proposed Rule 239 in an agreement relating to a security-based swap or on its publicly available website?
4. Are there additional burdens that we have not addressed in our preliminary burden estimates?

Persons wishing to submit comments on the collection of information requirements should direct them to the following persons: (1) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Office of Management and Budget, Room 3208, New Executive Office Building, Washington, DC 20503; and (2) Elizabeth Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-22-11. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is

best assured of having its full effect if OMB receives it within 30 days of publication. The Commission has submitted the proposed collection of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-22-11, and be submitted to the Securities and Exchange Commission, Records Management, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213.

## **V. Cost-Benefit Analysis**

As discussed above, we are proposing rules and amendments to existing rules to provide certain exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act for security-based swaps issued by a registered or exempt clearing agency in its function as a CCP.

### **A. Benefits**

The proposed rules are intended to further the goal of central clearing of security-based swaps by providing exemptions for the issuance of security-based swaps by a registered or exempt clearing agency in its function as a CCP from certain regulatory provisions that might otherwise interfere with such clearing activities. Without an exemption, 1) a clearing agency issuing a security-based swap in its function as a CCP would be required to register the security-based swap transaction; 2) the security-based swaps that are or have been issued or cleared by a registered or exempt clearing agency in its function as a CCP would have to be registered as a class of securities under the Exchange Act; and 3) the provisions of the Trust Indenture Act would apply. We believe that requiring compliance with these provisions likely would unnecessarily impede central clearing of security-based swaps and that the proposed exemptions are necessary to facilitate the intent of the Dodd-Frank Act with respect to mandatory clearing of security-based swaps. Absent these proposed exemptions, we believe that registered or exempt

clearing agencies would incur additional costs due to compliance with the registration requirements of the Securities Act and the Exchange Act solely because of their clearing functions.<sup>85</sup>

The proposed exemptions would treat security-based swaps issued or cleared by a registered or exempt clearing agency in its function as a CCP in the same manner as similar types of securities, such as security futures products and standardized options.<sup>86</sup> The proposed exemptions are similar to those provided for CDS under our temporary rules.<sup>87</sup> A registered or exempt clearing agency issuing security-based swaps in its function as a CCP would benefit from the proposed exemptions because it would not have to file registration statements covering the offer and sale of the security-based swaps. If a registered or exempt clearing agency is not required to register the offer and sale of security-based swaps, it would not have to incur the costs of such registration, including legal and accounting costs. Some of these costs, such as the costs of obtaining audited financial statements, may still be incurred by the clearing agency as a result of other regulatory requirements for clearing agencies.

Proposed Exchange Act Rule 12a-10 would provide that the Exchange Act Section 12(a) does not apply to any security-based swap that is issued by a registered or exempt clearing agency in reliance on proposed Securities Act Rule 239 and traded on a national securities exchange. In addition, proposed Exchange Act Rule 12h-1(h) would exempt from Section 12(g)

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<sup>85</sup> See, e.g., the rules proposed in the Mandatory Clearing Proposing Release and the Clearing Agencies Proposing Release.

<sup>86</sup> See, e.g., Securities Act Section 3(a)(14) [15 U.S.C. 77c(a)(14)]; Securities Act Rule 238 [17 CFR 230.238]; Exchange Act Section 12(a) [15 U.S.C. 78l]; and Exchange Act Rules 12h-1(d) and (e) [17 CFR 240.12h-1(d) and (e)].

<sup>87</sup> See Temporary CDS Exemptions Release.

security-based swaps that are issued by a registered or exempt clearing agency in reliance on proposed Securities Act Rule 239, whether or not such security-based swap is traded on a national securities exchange or a registered or exempt security-based SEF. Thus, the clearing agency would not incur the costs of registration or the costs associated with Exchange Act periodic reporting. The availability of exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act would mean that registered or exempt clearing agencies would not incur the costs associated with registering transactions or classes of securities, such as costs associated with preparing documents describing security-based swaps, preparing indentures, or arranging for the services of a trustee.

**B. Costs**

The proposed rules exempting offers and sales of security-based swaps that are or will be issued by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP should facilitate the use by eligible contract participants at minimal cost to the CCP or eligible contract participants. Because reliance on the proposed exemptions will not require any filing with or submission to us, other than costs incurred to comply with the information condition of proposed Rule 239, the costs of being able to rely on such exemptions, we believe, are minimal.

We recognize that a consequence of the proposed exemptions would be the unavailability of certain remedies under the Securities Act and the Exchange Act and certain protections under the Trust Indenture Act. Absent an exemption, a clearing agency may have to file a registration statement covering the offer and sale of the security-based swaps, may have to register the class of eligible security-based swaps that it has issued or cleared under the Exchange Act, and may have to satisfy the applicable provisions of the Trust Indenture Act, which would provide

investors with civil remedies in addition to antifraud remedies. A registration statement covering the offer and sale of security-based swaps may provide certain information about the clearing agency, security-based swap contract terms, and the identification of the particular reference securities, issuers, loans underlying the security-based swap. However, it would not necessarily provide the type of information necessary to assess the risk of the reference issuer, security, narrow-based security index, or loan. Further, while a registration statement would provide information to eligible contract participants, as well as to the market as a whole, registered clearing agencies already are required to make their audited financial statements and other information about themselves publicly available.<sup>88</sup> While an investor would be able to pursue an antifraud action in connection with the purchase and sale of security-based swaps under Exchange Act Section 10(b),<sup>89</sup> it would not be able to pursue civil remedies under Sections 11 or 12 of the Securities Act.<sup>90</sup> We could still pursue an antifraud action in the offer and sale of security-based swaps issued by a clearing agency.<sup>91</sup>

As previously discussed in the PRA, proposed Rule 239(c) would require a clearing agency availing itself of the Securities Act exemption to include in an agreement covering the security-based swap the clearing agency provides or makes available to its counterparty or include on a publicly available website maintained by the clearing agency:

- A statement identifying any security, issuer, loan, or narrow-based security index underlying the security-based swap;

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<sup>88</sup> See Regulation of Clearing Agencies, Release No. 34-16900 and Exchange Act Rule 19b-4(l) and (m).

<sup>89</sup> 15 U.S.C. 78j(b).

<sup>90</sup> 15 U.S.C. 77k and 77l.

<sup>91</sup> See 15 U.S.C. 77q and 15 U.S.C. 78j(b).

- A statement indicating the securities or loans to be delivered (or class of securities or loans), or if cash settled, the securities, loans or narrow-based security index (or class of securities or loans) whose value will determine the settlement obligation under the security-based swap; and
- A statement of whether the issuer of any security or loan, each issuer of a security in a narrow-based security index, or each referenced issuer underlying the security-based swap is subject to the reporting requirements of Exchange Act Section 13 or Section 15(d) and, if not subject to such reporting requirements, whether public information, including financial information, about any such issuer is available and where the information is available.

We preliminarily believe some of the information the clearing agency would make available would be the same information the clearing agency would be required to provide us under proposed Rule 19b-4 in connection with the mandatory clearing requirement, and the same information is collected and analyzed in making its business decision to plan to accept the security-based swap, or any group, category, type, or class of security-based swaps, for clearing. A clearing agency may incur costs in providing or making available this information in order to rely on the proposed exemption. We believe that the information requirements of proposed Rule 239 would be less burdensome to the clearing agency to the extent that it is already required to provide the information pursuant to Rule 19b-4 if adopted as proposed.

### **C. Request for Comment**

We request that commentators provide views and supporting information regarding the costs and benefits associated with the proposed rules. We seek estimates of these costs and benefits, as well as any costs and benefits not already identified herein. We also request

comment on whether other provisions of the Dodd-Frank Act for which Commission rulemaking is required are likely to have an effect on the costs and benefits of the proposed rules.

## **VI. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION**

Section 23(a)(2) of the Exchange Act<sup>92</sup> requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, Section 2(b)<sup>93</sup> of the Securities Act and Section 3(f)<sup>94</sup> of the Exchange Act require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation.

The rules we are proposing would exempt offers and sales of security-based swaps that are or will be issued to eligible contract participants by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP from all provisions of the Securities Act, other than the Section 17(a) antifraud provision, as well as from the registration requirements under Section 12 of the Exchange Act and the provisions of the Trust Indenture Act. Because these exemptions are available to any registered or exempt clearing agency offering and selling security-based swaps to an eligible contract participant, in its function as a CCP, we do not believe that the proposed exemptions impose a burden on competition. In contrast, we believe the proposed exemption would facilitate moving security-based swaps into

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<sup>92</sup> 15 U.S.C. 78w(a)(2).

<sup>93</sup> 15 U.S.C. 77b(b).

<sup>94</sup> 15 U.S.C. 78c(f).

centralized clearing, furthering the goal of the Dodd-Frank Act to reduce systemic risk while improving market access to hedging instruments that can contribute to lower costs of raising capital. In addition, we believe the proposal would promote efficiency by treating security-based swaps issued by clearing agencies in a manner similar to standardized options and security futures issued by clearing agencies. Harmonizing the regulatory treatment of these securities under the Securities Act, Exchange Act, and the Trust Indenture Act should reduce the potential for regulatory arbitrage between such products.

We also believe that the ability to novate security-based swaps with registered or exempt clearing agencies functioning as CCPs would improve the transparency of the security-based swap market and provide greater assurance to participants as to the capacity of the counterparty to perform its obligations under the security-based swap. We preliminarily believe that clearing agencies providing the information as would be required by proposed Rule 239(c) may promote competition and transparency among clearing agencies because it will make it easier for clearing agencies and eligible contract participants to determine what security-based swaps are being cleared. We preliminarily believe that increased transparency in the security-based swap market could help to limit market turmoil and thereby facilitate the capital formation process.

We generally request comment on the competitive or anticompetitive effects of the proposed exemptions on any market participants if adopted as proposed. We also request comment on what impact the exemptions, if adopted, would have on efficiency and capital formation. We request that commentators provide analysis and empirical data, if available, to support their views regarding any such effects. We also request comment regarding the competitive effects of pursuing alternative regulatory approaches that are consistent with the Dodd-Frank Act. In addition, we request comment on how the other provisions of the Dodd-

Frank Act for which Commission rulemaking is required, will interact with and influence the competitive effects of the proposed exemptions.

## **VII. CONSIDERATION OF IMPACT ON THE ECONOMY**

Under the Small Business Regulatory Enforcement Fairness Act of 1996,<sup>95</sup> a rule is considered “major” where, if adopted, it results or is likely to result in: (i) an annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (ii) a major increase in costs or prices for consumers or individual industries; or (iii) significant adverse effect on competition, investment or innovation. We request comment on the potential impact of the proposed exemptions on the economy on an annual basis, any potential increase in costs or prices for consumers or individual industries, and any potential effect on competition, investment or innovation. Commentators are requested to provide empirical data and other factual support for their view to the extent possible.

## **VIII. REGULATORY FLEXIBILITY CERTIFICATION**

The Regulatory Flexibility Act (“RFA”)<sup>96</sup> requires the Commission, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)<sup>97</sup> of the Administrative Procedure Act,<sup>98</sup> as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules to determine the impact of such rulemaking on “small entities.”<sup>99</sup> Section 605(b) of the RFA states that this requirement shall not

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<sup>95</sup> Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

<sup>96</sup> 5 U.S.C. 601 *et seq.*

<sup>97</sup> 5 U.S.C. 603(a).

<sup>98</sup> 5 U.S.C. 551 *et seq.*

<sup>99</sup> Section 601(b) of the RFA permits agencies to formulate their own definitions of “small entities.” The Commission has adopted definitions for the term “small entity” for the purposes of rulemaking in

apply to any proposed rule which, if adopted, would not have a significant economic impact on a substantial number of small entities.<sup>100</sup>

The exemptions would apply to all registered or exempt clearing agencies that issue or will issue security-based swaps in its function as a CCP. As noted above, four entities are currently exempt from registration as a clearing agency under Exchange Act Section 17A to provide central clearing services for CDS, a class of security-based swaps. Based on our understanding of the market, we preliminarily believe that between four and six clearing agencies will clear security-based swaps and would seek to avail themselves of the proposed exemptions.<sup>101</sup>

For the purposes of our rulemaking in connection with the RFA, a small entity includes, when used with reference to a clearing agency, a clearing agency that: (i) compared, cleared and settled less than \$500 million in securities transactions during the preceding fiscal year; (ii) had less than \$200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or at any time that it has been in business, if shorter); and (iii) is not affiliated with any person (other than a natural person) that is not a small business or small organization.<sup>102</sup> Under the standards adopted by the Small Business Administration, small entities in the finance industry include the following: (i) for entities engaged in investment banking, securities dealing and securities brokerage activities, entities with \$6.5 million or less in annual receipts; (ii) for entities engaged in trust, fiduciary and custody activities, entities with

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accordance with the RFA. These definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10 [17 CFR 240.0-10].

<sup>100</sup> See 5 U.S.C. 605(b).

<sup>101</sup> See also Section VIII. of the Mandatory Clearing Proposing Release.

<sup>102</sup> 17 CFR 240.0-10(d).

\$6.5 million or less in annual receipts; and (iii) funds, trusts and other financial vehicles with \$6.5 million or less in annual receipts.<sup>103</sup>

Based on our existing information about the entities likely to register to clear security-based swaps, the Commission preliminarily believes that such entities will not be small entities, but rather part of large business entities that exceed the thresholds defining “small entities” set out above. Additionally, while other clearing agencies may become eligible to operate as central counterparties for security-based swaps, we preliminarily do not believe that any such entities would be “small entities” as defined in Exchange Act Rule 0-10.<sup>104</sup> Furthermore, we believe it is unlikely that clearing agencies functioning as CCPs for security-based swaps would have annual receipts of less than \$6.5 million. Accordingly, we believe that any clearing agencies issuing security-based swaps in their function as CCPs in such transactions will exceed the thresholds for “small entities” set forth in Exchange Act Rule 0-12. We encourage written comments regarding this certification.

## **IX. STATUTORY AUTHORITY AND TEXT OF THE RULES AND AMENDMENTS**

The rules and amendments described in this release are being proposed under the authority set forth in Sections 19 and 28 of the Securities Act; Sections 3C, 12(h), 23(a) and 36 of the Exchange Act; and Section 304(d) of the Trust Indenture Act.

### **List of Subjects in 17 CFR Parts 230, 240 and 260**

Reporting and recordkeeping requirements, Securities.

### **TEXT OF THE RULES AND AMENDMENTS**

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<sup>103</sup> 13 CFR 121.201, Sector 52.

<sup>104</sup> See 17 CFR 240.0-10(d).

For the reasons set out in the preamble, the Commission is proposing to amend Title 17, Chapter II, of the Code of Federal Regulations as follows:

**PART 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933**

1. The authority citation for Part 230 continues to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

\* \* \* \* \*

2. Section 230.239 is added to read as follows:

**§ 230.239 Exemption for offers and sales of certain security-based swaps.**

(a) Provided that the conditions of paragraph (b) of this section are satisfied and except as expressly provided in paragraph (c) of this section, the Act does not apply to any offer or sale of a security-based swap that (i) is issued or will be issued by a clearing agency that is either registered as a clearing agency under Section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1) or exempt from registration under Section 17A of the Securities Exchange Act of 1934 pursuant to a rule, regulation, or order of the Commission (“eligible clearing agency”), and (ii) the Commission has determined is required to be cleared or that is permitted to be cleared pursuant to the eligible clearing agency’s rules.

(b) The exemption provided in paragraph (a) of this section applies only to an offer or sale of a security-based swap described in paragraph (a) of this section if the following conditions are satisfied:

(1) The security-based swap is offered or sold in a transaction involving the eligible clearing agency in its function as a central counterparty with respect to such security-based swap;

(2) The security-based swap is sold only to an eligible contract participant (as defined in Section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(12))); and

(3) The eligible clearing agency posts on its publicly available website at a specified Internet address or includes in its agreement covering the security-based swap that the eligible clearing agency provides or makes available to its counterparty the following:

(i) A statement identifying any security, issuer, loan, or narrow-based security index underlying the security-based swap;

(ii) A statement indicating the security or loan to be delivered (or class of securities or loans), or if cash settled, the security, loan, or narrow-based security index (or class of securities or loans) whose value is to be used to determine the amount of the settlement obligation under the security-based swap; and

(iii) A statement of whether the issuer of any security or loan, each issuer of a security in a narrow-based security index, or each referenced issuer underlying the security-based swap is subject to the reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m and 78o) and, if not subject to such reporting requirements, whether public information, including financial information, about any such issuer is available and where the information is available.

(c) The exemption provided in paragraph (a) of this section does not apply to the provisions of Section 17(a) of the Act (15 U.S.C. 77q(a)).

## **PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

3. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq., 18 U.S.C. 1350, and 12 U.S.C. 5221(e)(3), unless otherwise noted.

\* \* \* \* \*

4. Section 240.12a-10 is added to read as follows:

**§ 240.12a-10 Exemption of security-based swaps from section 12(a) of the Act.**

The provisions of Section 12(a) of the Act (15 U.S.C. 78l(a)) do not apply to any security-based swap that:

(a) Is issued or will be issued by a clearing agency registered as a clearing agency under Section 17A of the Act (15 U.S.C. 78q-1) or exempt from registration under Section 17A of the Act pursuant to a rule, regulation, or order of the Commission, in its function as a central counterparty with respect to the security-based swap;

(b) The Commission has determined is required to be cleared or that is permitted to be cleared pursuant to the clearing agency's rules;

(c) Is sold to an eligible contract participant (as defined in Section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)) in reliance on Rule 239 under the Securities Act of 1933 (17 CFR 230.239); and

(d) is traded on a national securities exchange registered pursuant to Section 6(a) of the Act (15 U.S.C. 78f(a)).

5. Section 240.12h-1 is amended by adding paragraph (h) to read as follows:

**§ 240.12h-1 Exemptions from registration under section 12(g) of the Act.**

\* \* \* \* \*

(h) Any security-based swap that is issued by a clearing agency registered as a clearing agency under Section 17A of the Act (15 U.S.C. 78q-1) or exempt from registration under Section 17A of the Act pursuant to a rule, regulation, or order of the Commission in its function as a central counterparty that the Commission has determined must be cleared or that is permitted to be cleared pursuant to the clearing agency's rules, and that was sold to an eligible contract participant (as defined in Section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)) in reliance on Rule 239 under the Securities Act of 1933.

**PART 260 – GENERAL RULES AND REGULATIONS, TRUST INDENTURE ACT OF 1939**

6. The authority citation for Part 260 continues to read as follows:

Authority: 15 U.S.C. 77eee, 77ggg, 77nnn, 77sss, 78ll(d), 80b-3, 80b-4, and 80b-11.

\* \* \* \* \*

7. Section 260.4d-11 is added to read as follows:

**§ 260.4d-11 Exemption for security-based swaps offered and sold in reliance on Rule 239 under the Securities Act of 1933 (17 CFR 230.239).**

Any security-based swap offered and sold in reliance on Rule 239 of this chapter (17 CFR § 230.239), whether or not issued under an indenture, is exempt from the Act.

By the Commission.

Elizabeth M. Murphy  
Secretary

Date: June 9, 2011