

**MEMO# 29854**

April 25, 2016

# **SEC Adopts Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants and Addresses Cross-Border Application of the Standards to Non-U.S. Funds**

[29854]

April 25, 2016

TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 16-16

ICI GLOBAL REGULATED FUNDS COMMITTEE No. 28-16

INTERNATIONAL MEMBERS No. 7-16

SECURITIES OPERATIONS ADVISORY COMMITTEE RE: SEC ADOPTS BUSINESS CONDUCT STANDARDS FOR SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS AND ADDRESSES CROSS-BORDER APPLICATION OF THE STANDARDS TO NON-U.S. FUNDS

Recently, the Securities and Exchange Commission (“SEC”) adopted new business conduct standards under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) for security-based swap dealers (“SBS Dealers”) and major security-based swap participants (“Major SBS Participants”) (together “SBS Entities”). [\[1\]](#) In conjunction, the SEC adopted rules regarding the cross-border application of those standards and the availability of substituted compliance. The business conduct standards are part of a series of rules for security-based swaps that the SEC intends to adopt under Title VII of the Dodd Frank Act. With each new substantive requirement, the SEC will address separately the cross-border application of the rule. [\[2\]](#) This memorandum briefly discusses the application of the business conduct standards of foreign SBS Entities with respect to their transactions with non-U.S. funds.

Under the new business conduct standards, the SEC would require, among other things, SBS Entities: (1) to verify counterparty status as an eligible contract participant or special entity; (2) to disclose to the counterparty material information about the security-based swap; (3) to disclose information concerning the daily mark of the security-based swap; (4) to disclose the ability of the counterparty to require clearing of the security-based swap; (5) to communicate with counterparties in a fair and balanced manner based on principles of

fair dealing and good faith; and (6) to establish supervisory and compliance infrastructure.

A registered U.S. SBS Dealer would be required to comply with the transaction-level business conduct requirements (which apply to specific transactions rather than the entity as a whole) with respect to all of its transactions, except for certain transactions conducted through such dealer's foreign branch. [3] The new rules also would require a registered foreign SBS Dealer to comply with transaction-level business conduct requirements with respect to any transaction with a U.S. person (except for a transaction conducted through a foreign branch of the U.S. person) and any transaction that the SBS Dealer arranges, negotiates, or executes using personnel located in the United States. Therefore, the business conduct standards would apply to a transaction between a non-U.S. SBS Dealer and a non-U.S. fund, such as a UCITS, that was arranged, negotiated, or executed by personnel of the foreign SBS Dealer located in the United States or by personnel of its agent located in a U.S. branch or office. The final rules also provide a framework under which foreign SBS Entities may seek to satisfy certain business conduct requirements under Title VII by substituted compliance.

The aspects of the rule with respect to foreign SBS Dealers and non-U.S. persons (including non-U.S. funds) were adopted generally as proposed without modifications despite concerns expressed by commenters, including ICI Global. [4] Our letter had argued that, although the external business conduct standards apply directly to SBS Dealers (and not directly to regulated funds), non-U.S. regulated fund counterparties may not be aware whether a foreign SBS Dealer is using personnel in the United States to arrange, negotiate, or execute transactions. Therefore, the letter expressed concern that these funds could face interruptions in their investment activities because they may not have the documentation in place required by the SBS Dealer to satisfy its own regulatory obligation. The location of a foreign SBS Dealer also could change over time, which could lead to further uncertainty for foreign regulated funds that seek to trade with foreign SBS Dealers. The SEC acknowledged that application of these requirements may "impose costs on asset managers servicing non-U.S. clients and impede their ability to execute certain block trades." The SEC, however, was of the view that the rules appropriately balanced the regulatory objectives of the business conduct rules with concerns for a workable approach.

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#### **endnotes**

[1] Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Release No. 34-77617 (Apr. 14, 2016), available at <http://www.sec.gov/rules/final/2016/34-77617.pdf>. The new rules also address the designation of a chief compliance officer for security-based swap dealers and major security-based swap participants, which are not discussed in this memorandum.

[2] Earlier this year the SEC adopted rules explaining the application of the SBS Dealer registration requirement to foreign dealers who arrange, negotiate, or execute security-based swaps with non-U.S. counterparties in the United States. SEC rules generally would require any person who engages in more than a de minimis amount of security-based swap dealing activity to register with the Commission as an SBS Dealer. Consistent with the recommendation of ICI Global, these rules make clear that the foreign dealer must consider

only the location from which it or its agent arranges, negotiates or executes the security-based swap. The location of the dealer's non-U.S. counterparty plays no role in determining whether the transaction counts toward the dealer's de minimis threshold. Security-Based Swap Transactions Connected with a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed By Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception, Release No. 34-77104 (Feb. 10, 2016), available at <https://www.sec.gov/rules/final/2016/34-77104.pdf>. See Letter from Dan Waters, Managing Director, ICI Global, to Brent J. Fields, Secretary, SEC, dated July 13, 2015, available at <https://www.ici.org/pdf/29173.pdf> ("ICI Global Comment Letter").

[3] Similarly, the rules would require a registered U.S. Major SBS Participant to comply with transaction-level business conduct requirements with respect to all of its transactions, except for certain transactions conducted through such participant's foreign branch. The rules also would require a registered foreign Major SBS Participant to comply with transaction-level business conduct requirements with respect to any transaction with a U.S. person (except for a transaction conducted through a foreign branch of the U.S. person) but not any transaction with a non-U.S. person.

[4] ICI Global Comment Letter at 5-6.