

**MEMO# 31469**

November 6, 2018

# SEC Issues Statement on Security-Based Swap Business Conduct Standards

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November 6, 2018 TO: Derivatives Markets Advisory Committee RE: SEC Issues Statement on Security-Based Swap Business Conduct Standards

The Securities and Exchange Commission (SEC or Commission) recently issued a statement regarding compliance with the Commission's rules imposing business conduct standards on security-based swap dealers ("SBS Dealers") and major security-based swap participants ("Major SBS Participants" and together with SBS Dealers, "SBS Entities"). The statement sets forth the Commission's position that certain activities with respect to specified provisions of the Commission's business conduct rules will not provide a basis for enforcement action for five years following the compliance date for the SBS Entity registration rules.[\[1\]](#)

The Commission's statement is designed to allay concerns market participants have expressed about compliance difficulties resulting from differences between the Commission's business conduct rules for SBS Entities, which were adopted in 2016, and the U.S. Commodity Futures Trading Commission's (CFTC) business conduct rules for swap dealers and major swap participants, which were adopted in 2012. The statement acknowledges the widespread use by market participants of standardized documentation to comply with the CFTC's business conduct rules and the potentially burdensome changes that may be necessary to comply with the SEC's rules.

The SEC's statement aims to minimize potential market disruptions that could result from documentation issues associated with compliance with the SEC's business conduct rules for SBS Entities. The statement provides relief for four activities. One of the activities concerns an SBS Dealer's reliance on previously-obtained written representations. The other three relate to the treatment of special entities (*i.e.* federal agencies and states, political subdivisions of states and state agencies and instrumentalities, certain pension systems, and certain endowments).

## **Reliance on Previously-Obtained Written Representations**

Exchange Act Rule 15Fh-1(b) permits an SBS Entity to rely on written representations from a counterparty or its representative to satisfy due diligence requirements under the rules.[\[2\]](#) The statement would permit an SBS Dealer to rely on a representation from a counterparty or representative that was previously provided in relation to swaps, unless the

SBS Dealer is aware of information that would cause a reasonable person to question the accuracy of the representation.

## Special Entities

- **Non-ERISA Employee Benefit Plans.** The Commission's statement would permit an SBS entity to consider an employee benefit plan, as defined in Exchange Act Rule 15Fh-2(d)(4),<sup>[3]</sup> not to be a special entity, as long as: (1) the plan previously represented in writing to the SBS Entity that it is not a special entity under the CFTC's business conduct rules; (2) the SBS Entity notifies the plan in writing, before entering into a security-based swap with the plan, that it may opt into special entity status; and (3) the plan does not opt into special entity status.
- **Written Representations that SBS Dealers Are not Acting as Advisors.** Under the statement, an SBS Dealer may rely on certain representations made by a special entity for purposes of the CFTC's business conduct rules for swaps to satisfy the safe harbor to be deemed not to "act as an advisor to a special entity" under Exchange Act Rule 15Fh-2.
- **Safe Harbor for SBS Entities Acting as Counterparties to Special Entities.** With respect to a safe harbor available for SBS Entities acting as counterparties to a special entity other than an employee benefit plan subject to Title I of ERISA, the Commission's statement allows an SBS Entity to rely on a written representation from the representative of the special entity that the representative has written policies and procedures reasonably designed to ensure that the requirements of Exchange Act Rule 15Fh-5(b) for acting as a qualified independent representative are satisfied.

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### endnotes

<sup>[1]</sup> See Commission Statement on Certain Provisions of Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, SEC Release No. 34-84511, available at <https://www.sec.gov/rules/policy/2018/34-84511.pdf>.

<sup>[2]</sup> The Commission's business conduct rules are codified as Exchange Act Rules 15Fh-1 through 15Fh-6.

<sup>[3]</sup> Rule 15Fh-2(d)(4) defines "special entity" to include: "An employee benefit plan as defined in section 3 of [ERISA] and not otherwise defined as a special entity, unless such employee benefit plan elects not to be a special entity by notifying a security-based swap dealer or major security-based swap participant of its election prior to entering into a security-based swap with the particular security-based swap dealer or major security-based swap participant."

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