December 21, 2012

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Exemptions for Security-Based Swaps: Uncleared Security-Based Swap Transactions Involving Eligible Contract Participants (File Number S7-26-11)

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to comment further on the interim final rules promulgated by the U.S. Securities and Exchange Commission (the "**Commission**") temporarily exempting uncleared security-based swaps ("**SBS**") entered into between eligible contract participants (as defined in Section 1a(18) of the Commodity Exchange Act) from certain provisions of the Securities Act of 1933, as amended (the "**Securities Act**"), the Securities Exchange Act of 1934, as amended (the "**Exchange Act**") and the Trust Indenture Act of 1939, as amended.[2] This letter supplements our letter submitted jointly with the International Swaps and Derivatives Association, Inc. on April 20, 2012,[3]

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[2] Exemptions for Security-Based Swaps, Rel. Nos. 33-9231; 34-64794; 39-2475, 76 Fed. Reg. 40,605 (July 1, 2011).

[3] Letter from Kenneth E. Bentsen, Jr., Exec. V.P., SIFMA, and Robert Pickel, Chief Exec. Officer, ISDA, to Elizabeth M. Murphy, Sec'y, SEC (Apr. 20, 2012), *available at* http://www.sec.gov/comments/s7-26-11/s72611-5.pdf.

requesting, among other things, that the Commission permanently exempt SBS transactions involving eligible contract participants from the registration requirements of Section 5 of the Securities Act, and provides additional discussion as to why such an exemption is necessary and appropriate.

As described in our April 2012 letter, the SBS market consists of bilateral contracts privately negotiated between SBS dealers and sophisticated counterparties, with no secondary resale market. Given the nature of this market, one might ask whether the statutory exemption from registration provided by Section 4(a)(2) of the Securities Act,[4] for "[t]ransactions by an issuer not involving any public offering," would not already be available to exempt SBS transactions from the registration requirements of the Securities Act. Because activity that involves a "general solicitation or general advertising"[5] (hereinafter, "**general solicitation**") can in some cases prevent reliance on the Section 4(a)(2) exemption,[6] of chief concern is the fact noted in our April 2012 letter that SBS dealers or their affiliates publish and distribute SBS research to existing and prospective clients, some of which may be available on an unrestricted basis.[7] The Commission recognizes that research reports can sometimes be viewed to involve a general solicitation with respect to the subject securities.[8] Although we

[4] Previous Section 4(2) of the Securities Act was renumbered to Section 4(a)(2) by the Jumpstart Our Business Startups Act of 2012.

[5] *See* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Rel. No. 33-9354, 77 Fed. Reg. 54,464 (Aug. 29, 2012), text at n. 19 ("Although the terms 'general solicitation' and 'general advertising' are not defined in Regulation D, Rule 502(c) does provide examples of general solicitation and general advertising, including advertisements published in newspapers and magazines, communications broadcast over television and radio, and seminars whose attendees have been invited by general solicitation or general advertising.").

[6] Revisions of Limited Offering Exemptions in Regulation D, Rel. No. 33-8828, 72 Fed. Reg. 45,116 (Aug. 3, 2007), text following n. 127 ("[I]t is our view that the determination as to whether the filing of the registration statement should be considered to be a general solicitation or general advertising that would affect the availability of the Section 4(2) exemption for such a concurrent unregistered offering should be based on a consideration of whether the investors in the private placement were solicited by the registration statement or through some other means that would otherwise not foreclose the availability of the Section 4(2) exemption.").

[7] *See* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, *supra* note 5, text at n. 20 ("[T]he Commission has confirmed that other uses of publicly available media, such as unrestricted websites, also constitute general solicitation and general advertising.").

[8] Securities Offering Reform, Rel. Nos. 33-8591; 34-52056; IC-26993, 70 Fed. Reg. 44,722 (July 19, 2005), at n. 380 (explaining that research can create general solicitation concerns in the context of a Rule 144A offering: "Where [a broker or dealer] distributes research about the issuer around the time of a Rule 144A transaction, questions arise regarding whether it may be viewed as making offers to persons that receive the research, including those who are not QIBs.").

believe that the Section 4(a)(2) exemption would in fact be available for most if not all SBS transactions in light of the Commission's 2007 guidance explaining that general solicitation does not prevent reliance on Section 4(a)(2) when investors are solicited through "means that would otherwise not foreclose the availability of the Section 4(2) exemption,"[9] a permanent Section 5 exemption is needed to provide certainty to market participants, to ensure that investors have access to SBS research and to avoid the need for cumbersome and expensive compliance procedures to prevent a technical Section 5 violation.[10]

SBS research reports are produced in the ordinary course of business by SBS dealers and their affiliates. The most commonly discussed SBS in research reports is the credit default swap ("**CDS**"). This is due to the large, liquid nature of the CDS market, with the most active names trading up to 100 contracts a week, each representing $5 million notional amount of credit exposure. CDS are typically and routinely discussed in research reports published either by fundamental credit analysts, who may use the CDS as one expression of a particular issuer's credit risk in comparison to the outstanding debt securities of that issuer or another issuer, or credit strategists, who may also use CDS to compare relative credit risk between different issuers.

As is customary, SBS research often contains statements that could theoretically be construed as an "offer" to sell the subject SBS under the Commission's longstanding interpretations,[11] and therefore potentially presents a

[9] Revisions of Limited Offering Exemptions in Regulation D, *supra* note 6, text following n. 127.

[10] Please see our April 2012 letter, *supra* note 3, for a general discussion of how dealers currently disseminate SBS quotes. Although we believe the pre-clearance procedures generally employed by dealers and trading platforms should offset any concern that SBS quote dissemination entails a general solicitation, a categorical Section 5 exemption would provide certainty to the market in this regard. Furthermore, a categorical Section 5 exemption would ease the way forward to making SBS available to trade on an SBS trade execution facility should one develop in the future.

[11] *See, e.g., In the Matter of Carl M. Loeb, Rhoades & Co.*, 38 S.E.C. 843 (1959) ("In permitting, but limiting the manner in which pre-effective written offers might be made, the Congress was concerned lest inadequate or misleading information be used in connection with the distribution of securities. We were directed to pursue a vigorous enforcement policy to prevent this from happening. In obedience to this mandate we have made clear our position that the statute prohibits issuers, underwriters and dealers from initiating a public sales campaign prior to the filing of a registration statement by means of publicity efforts which, even though not couched in terms of an express offer, condition the public mind or arouse public interest in the particular securities." (footnotes omitted)) ; Guidelines for the Release of Information by Issuers Whose Securities Are in Registration, Rel. No. 33-5180, 36 Fed. Reg. 16,506 (Aug. 16, 1971) ("[T]he publication of information and statements, and publicity efforts, made in advance of a proposed financing which have the effect of conditioning the public mind or arousing public interest in the issuer or in its securities constitutes an offer…").

general solicitation at odds with the private character of a Section 4(a)(2) transaction.[12] The following are a few examples of such statements, taken from SBS research reports recently in the market:

> "*With [XYZCo] 5-year CDS now at 6.75 points up front and 4Q demand still uncertain, we think the potential downside outweighs the upside. We continue to recommend buying [XYZCo] 5-year CDS vs. selling [ABCCo] 5 year CDS.*"
>
> "*[LMNCo] five year CDS is close to 200 bps tighter since 2Q results and 55 bps tighter in just the last few days. Market technicals could drive spreads tighter from here but we would consider buying protection in the low 300 bps area.*"
>
> "*[EFGCo] CDS trades at 95bps and offers an attractive entry point from the short side based on 1) relative value, 2) integration risk from the [PQRCo] transaction and 3) our view that leverage will likely remain elevated as the company becomes increasingly reliant on M&A to diversify its product and footprint.*"
>
> "*We'd recommend buying [JKLCo]sub CDS at 267bp and selling [TUVCo] sub at 215bp, paying 52bp. . . . We'd also recommend buying [JKLCo] senior CDS versus [TUVCo] senior, paying just 11bp.*"

To be certain, it is not necessarily the case that the publication of any of the statements quoted above would constitute a general solicitation that would foreclose the availability of the Section 4(a)(2) exemption for a particular SBS transaction. Instead, determining (i) whether or not such a statement would be viewed by the Commission or its staff as something likely to "condition the public mind or arouse public interest in the particular securities"[13] and if so, (ii) whether the potential counterparty became interested in the particular SBS transaction through the publication of the "offer" or through some permissible means, would

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[12] Integration of Abandoned Offerings, Rel. No. 33-7943, 66 Fed. Reg. 8,887 (Jan. 26, 2001) (text accompanying n. 31) ("[W]e do not believe that general solicitation or advertising is permissible in an offering under Section 4(2)."); *see also* Revisions of Limited Offering Exemptions in Regulation D, *supra* note 6, at n. 37 ("An issuer engaging in the limited advertising permitted by Rule 507 may not be able to claim the Section 4(2) exemption if the activity has imparted a public character to the offering") & n. 75 ("Because some advertising would be permitted in Rule 507 transactions, we have chosen not to propose the exemption under Section 4(2) of the Securities Act, which the Commission in the past has viewed as incompatible with a non-public offering under Section 4(2).").

[13] *In the Matter of Carl M. Loeb, Rhoades & Co., supra* note 11.

involve a time-consuming, fact-intensive judgment call. Given the downside risk in a conclusion that the Section 4(a)(2) exemption is available for the SBS transaction in question,[14] absent the relief requested in this letter, the SBS dealer may conclude for risk-mitigation purposes either to withhold or limit publication of the research in order to maintain flexibility to deal with all potential counterparties, or to decline to do business with the potential counterparty. We believe that it is unnecessary for the protection of investors to force SBS dealers to make this sort of choice. Eligible contract participants are sophisticated investors and it seems entirely unnecessary to deprive them of SBS research, or to bar them from trading with particular SBS dealers, in the service of a doctrine designed to protect the general public from "inadequate or misleading information [being] used in connection with the distribution of securities."[15] The general public does not invest in SBS and is therefore not the audience for SBS research; Congress made this all the more likely to remain the case by enacting Section 768(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"), which forbids the use of unregistered transactions to sell SBS to investors who are not eligible contract participants.

The Commission has for decades recognized that even though research reports issued by broker-dealers or their affiliates may contain statements that could be construed as "offers" of the subject securities, the market benefit in permitting the publication of research, even when the broker-dealer may be actively involved in transactions in the subject securities, often may outweigh the potential harm.[16] Likewise, in the unregistered offering context, the Commission in 2005 expressed concern that the restrictions in "Rule 144A on offers to non-qualified institutional buyers ("**QIBs**") and general solicitation have resulted in

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[14] In addition to Commission enforcement risk, a counterparty would have a right to rescind the transaction under Section 12(a)(1) of the Securities Act if the transaction violated Section 5.

[15] *In the Matter of Carl M. Loeb, Rhoades & Co., supra* note 11.

[16] *See, e.g.*, Adoption of Rules Relating to Publication of Information and Delivery of Prospectus by Broker-Dealers Prior to or After the Filing of a Registration Statement Under the Securities Act of 1933, Rel. Nos. 33-5101; 34-9010, 35 Fed. Reg. 18,456 (Nov. 19, 1970) ("Information, opinions or recommendations by a broker-dealer about securities of an issuer proposing to register securities under the Securities Act of 1933 for a public offering or having securities so registered, may constitute an offer to sell such securities within the meaning of Sections 2(3) and 5 of that Act, particularly when the broker-dealer is to participate in the distribution as an underwriter or selling group member. Publishing such information may result in a violation of Section 5 of the Act. It is the purpose of the adopted rules to provide guidance to broker-dealers and to alleviate such requirements where it appears that the purposes and policies of the Act will not be prejudiced while assuring that persons engaged in the distribution of a registered offering and their customers will be supplied with the disclosure afforded by the statutory prospectus.").

brokers and dealers unnecessarily withholding regularly published research."[17] To address these concerns, in 1970 the Commission promulgated a series of Securities Act safe harbors, Rules 137, 138 and 139, amended in 2005, to allow for the publication and distribution of research during ongoing registered and unregistered distributions of subject securities.

Because SBS research practices developed under a regulatory regime in which SBS were not "securities" for purposes of the Securities Act, the Commission has not previously needed to clarify the circumstances under which SBS research would not constitute an offer to sell the subject SBS for purposes of Section 2(a)(10) or Section 5 of the Securities Act or a general solicitation in the context of an unregistered private placement. As a result, although SBS research reports would be encompassed by the definition of "research report" contained in Rule 137(e), Rule 138(d) and Rule 139(d),[18] none of these rules would provide a safe harbor for research in the context of an SBS transaction. Rule 137 is inapplicable because it is limited in scope to registered offerings. Although Rules 138 and 139 apply to some specific forms of unregistered offerings, they do not apply to Section 4(a)(2) private placements, and U.S.-based SBS transactions as currently conducted do not comply with Rule 144A under the Securities Act, which applies to resales of securities to QIBs but not to primary issuances, or with Regulation S under the Securities Act, which is available only for offshore transactions.

Even if the safe harbors in Rules 137, 138 and 139 were expanded to cover Section 4(a)(2) private placements, the research rules as currently structured would inhibit SBS research as it exists today, with SBS dealers or their affiliates publishing and distributing research on SBS in which they are, at the same time, transacting and available to transact. Rule 137 provides a safe harbor for research written by a dealer that is not participating in an offering of the subject security; this safe harbor would be inapplicable because SBS dealers regularly transact business in the same SBS that are covered by their research reports. Rule 138 provides a safe harbor for research written about a qualifying issuer's debt securities in the context of an offering of its equity securities, and vice versa; this safe harbor would be inapplicable because SBS research concerns the SBS itself. Rule 139 allows for the publication and distribution of research on a security even by a dealer engaged in a transaction involving the security, but for issuer-specific reports the rule is limited in scope to securities of an issuer eligible to use Form

[17] Securities Offering Reform, *supra* note 8, text at n. 381 (footnotes omitted).

[18] Each rule defines "research report" as "a written communication, as defined in Rule 405, that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision."

S-3 or Form F-3 or, in the case of a non-U.S. company only, a foreign private issuer with equity securities trading on a designated offshore securities market or with a non-affiliated equity float of at least $700 million. Given the bilateral nature of SBS, it would be unclear whether to apply Rule 139's issuer requirements to both the SBS dealer (or its public company parent) and to the counterparty (which would be a major hindrance to the usefulness of the safe harbor), or just to the dealer or its parent; or perhaps only to the issuer of the reference security (if any); or to some combination of these entities.

The Commission's existing safe harbors therefore will not accommodate ordinary-course SBS research once SBS are treated as securities for Securities Act definitional purposes. But rather than graft amendments onto the Commission's research report rules in order to allow the SBS market to function under the Section 4(a)(2) exemption, we believe that the best approach is to exempt SBS transactions from Section 5. As discussed below, we believe this approach is consistent with Congressional intent as embodied in the Dodd-Frank Act and the Jumpstart Our Business Startups Act of 2012 (the "**JOBS Act**").

Section 768(b) of the Dodd-Frank Act amended Section 5 of the Securities Act to add a new paragraph (d), which provides that the exemptions from Section 5 found in Sections 3 and 4 of the Securities Act are unavailable for any offer or sale of an SBS to any person who is not an eligible contract participant. By limiting mandatory Securities Act registration to SBS transactions involving non-eligible contract participants, Congress contemplated that the SBS market among eligible contract participants could remain outside of the registration regime of Section 5 of the Securities Act. There is no indication in the Dodd-Frank Act text or legislative history that Congress intended to rein in or limit the publication and distribution of SBS research, which would be the practical consequence of requiring unregistered SBS transactions involving eligible contract participants to be carried out in accordance with the Section 4(a)(2) exemption. Exempting SBS transactions from Section 5 categorically would therefore achieve the intended Congressional result, without forcing unnecessary changes to current market practices and unnecessarily limiting the availability of research to sophisticated investors.

The consistency of this approach with Congressional intent is reinforced by the recent adoption of the JOBS Act. Section 201(a)(1) of the JOBS Act directed the Commission to permit general solicitation in offerings made under Rule 506 of Regulation D under the Securities Act, provided that all purchasers of the securities are accredited investors. Section 201(a)(2) of the JOBS Act directed the Commission to revise Rule 144A(d)(1) under the Securities Act to permit offers of securities pursuant to Rule 144A to persons other than QIBs, including by means of general solicitation, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs. Although a typical SBS transaction is not conducted

in accordance with the Rule 506 or Rule 144A safe harbor, Congressional policy underlying the elimination of the prohibition on general solicitation in both Rule 144A and Rule 506 transactions supports our view that SBS that are sold only to persons who are eligible contract participants, who Congress has determined are sufficiently sophisticated not to need the protections of Securities Act registration, should be exempt from registration, regardless of whether the transaction involves a general solicitation.

Although the publication of SBS research necessitates a categorical exemption from registration for all SBS transactions involving eligible contract participants, such an exemption would not represent a significant expansion of existing Commission precedent. In addition to the research report safe harbors discussed above, the Commission's staff has on other occasions relaxed prohibitions on the solicitation of orders in order to prevent interference with customary research practices.[19] The Commission need not be concerned that creating the requested Section 5 exemption for SBS transactions would leave it unable to police SBS research or other market practices in the event a broad public market in SBS develops, because the exemption would apply only to transactions involving eligible contract participants and no other registration exemption is available for investors who are not eligible contract participants. The Commission can therefore defer action on how to adapt the research report safe harbors until such time (if ever) that a registered market in SBS develops.

The Commission has authority under Section 28 of the Securities Act to exempt any "transaction" or any "class of transactions" from any provision or provisions of the Securities Act, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors. We believe that an exemption from Section 5 of the Securities Act for SBS transactions involving eligible contract participants is needed to avoid unnecessary disruption to the SBS market as well as to implement Congressional

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[19] For example, in analyzing whether a research report would be viewed as a "solicitation" in the context of a Rule 144 sale, the Commission's staff provided guidance in 1978 to the effect that:

> "A broker may issue research reports concerning the issuer of the underlying securities of an option written by its client [covering restricted securities] during the time of such writing and through the time of exercise and delivery of the underlying securities, provided that (i) the reports are issued in the broker's regular course of business; (ii) such reports concerning the issuer have been previously issued by the broker; (iii) the broker receives no consideration from its client in regard to the issuance of such reports; and (iv) the reports are not issued for the purpose of facilitating any aspect of the client's transaction."

Dean Witter Reynolds Inc., SEC No-Action Letter (Oct. 16, 1978).

intent as demonstrated in the Dodd-Frank Act and the JOBS Act, and that such an exemption is therefore in the public interest. Given the sophisticated character of eligible contract participants, and the fact that Congress has already determined that SBS transactions involving eligible contract participants may be carried out without registration under the Securities Act, we believe such an exemption is consistent with the protection of investors.

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If you have any questions with respect to the matters discussed in this letter, or require any further information, please feel free to contact the undersigned, or our counsel at Davis Polk & Wardwell LLP, Annette L. Nazareth at (202) 962-7075 or Joseph A. Hall at (212) 450-4565.

Very truly yours,

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Kenneth E. Bentsen, Jr.
Executive Vice President
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cc: Hon. Elisse B. Walter, Chairman
Hon. Luis A. Aguilar, Commissioner
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