



## **Proposed Guidance and Exemptions to Clarify Treatment of Security-Based Swaps Under the Exchange Act**

The following guidance and exemptions relating to the treatment of security-based swaps (“SBS”) as “securities” under the Securities Exchange Act of 1934 (the “Exchange Act”) and rules of the Securities and Exchange Commission (“SEC”) thereunder are proposed to provide legal certainty to the SBS markets and account for the SBS-specific provisions of the Exchange Act and SEC rules thereunder.

The proposed exemptions would apply on a permanent basis, replacing the temporary exemptions set forth in Release No. 34-71485 and relating to pending SBS rulemakings (the “Linked Temporary Exemptions”), as well as those that generally were not directly related to a specific SBS rulemaking (the “Unlinked Temporary Exemptions”). Because the Unlinked Temporary Exemptions are currently, under Release No. 34-82626, set to expire on February 5, 2019, an additional extension of that exemption will be necessary to provide an orderly transition to the more limited range of exemptions proposed below, most of which should take effect on the registration compliance date for SBS dealers and major SBS participants. In addition, the Linked Temporary Exemptions should continue to apply until the relevant compliance dates set forth in Release No. 34-71485, even if they are not covered by one of the exemptions proposed below, and those compliance dates should take into account the expiration of those exemptions where relevant.<sup>1</sup>

### **Exemptions to Provide Legal Certainty to the SBS Market**

- **Regulation of Penny Stocks.** It may not always be clear that an SBS is not a “penny stock” (e.g., because the price of the SBS in dollar terms might not always be clear). To provide certainty on this matter, SBS between eligible contract participants should be exempted from the definition of “penny stock” in Section 3(a)(51) and Rule 3a51-1.
- **Regulation of Municipal or Government Securities.** Guidance should be provided that, for purposes of provisions of the Exchange Act, including Sections 15B and 15C, and rules thereunder applicable to municipal or government securities, an SBS with a counterparty that is a municipal or U.S. government-related entity, respectively, should not be considered a municipal or government security solely due to the identity of the counterparty.

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<sup>1</sup> In connection with some of the provisions covered by Linked Temporary Exemptions, such as Rules 15c3-1, 15c3-3, 17a-3, 17a-4, and 17a-5, SIFMA has provided and may in the future provide comments regarding how those provisions should apply to SBS.

- Section 31 Fees. Guidance should be provided that SBS are not subject to transactions fees under Section 31 of the Exchange Act and rules thereunder merely because SBS are subject to transaction reporting under Regulation SBSR. This clarification would help address the fact that, although most SBS transactions should qualify as “exempt sales” under Rule 31 because they qualify for Section 4(a)(2) of the Securities Act of 1933 (the “Securities Act”), the status of some SBS transactions (such as cleared SBS offered or sold pursuant to Rule 239 under the Securities Act) is not as clear.

### Exemptions to Account for SBS-Specific Regulation

- Regulation of SBS Execution Facilities. Consistent with the SEC’s 2011 proposal (Release No. 34-63825), an SBS execution facility (“SB SEF”) should be subject to conditional exemptions from the definition of “exchange” in Section 3(a)(1) and regulation as broker-dealers. As SB SEFs will be covered by their own comprehensive regulatory framework under Regulation SB SEF, an additional requirement for them to register and be regulated as national securities exchanges or broker-dealers would be duplicative.<sup>2</sup> The SEC should also confirm that the exemption from the “exchange” definition exempts an SBS execution facility from regulation as an “alternative trading system.”
- Broker-Dealer Registration. A person whose only securities dealing activity involves SBS with eligible contract participants (“ECPs”) is not considered a “dealer” under Section 3(a)(5). However, a foreign person engaged in non-SBS broker or dealer activity solely outside the U.S. or otherwise in compliance with Rule 15a-6 would still fall within Section 3(a)(5)’s “dealer” definition or Section 3(a)(4)’s “broker” definition. As a result, and because Section 15(a)(1) is phrased to require any “broker” or “dealer” to register as such with the SEC if it makes “use of the mails or any means or instrumentality of interstate commerce to . . . induce or attempt to induce the purchase or sale of, any security”—now including an SBS—such a foreign person could still trigger the broker-dealer registration requirement by transacting in SBS directly with U.S.-based ECPs. But requiring such a person to register as a broker-dealer would not be necessary because all of its U.S.-related securities brokerage and dealing activity would be covered by Rule 15a-6 and the separate SBS dealer regulatory regime. To address this issue, an exemption from Section 15(a)(1) should apply to a foreign broker or dealer (as defined in Rule 15a-6) in connection with inducing or attempting to purchase or sale of an SBS with an ECP.
- Confirmation Requirements. The exemption from the broker-dealer confirmation requirements in Rule 10b-10 contained in Rule 15Fi-2 should be expanded to cover a situation where a broker-dealer is purchasing or selling an SBS as agent on behalf of an SBS dealer or major SBS participant that is subject to the trade acknowledgment and verification requirements of Rule 15Fi-2.

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<sup>2</sup> See Release No. 34-63825 (Feb. 2, 2011) at p. 38-49.

- Margin Regulations. Since SBS dealers and major SBS participants will be subject to SBS-specific margin requirements under proposed Rule 18a-3 or Prudential Regulator margin rules, as applicable and pursuant to Section 15F(e), their SBS should be exempt from margin requirements under Section 7 and Regulations T, U, and X, except to the extent that their SBS are carried in a securities account and portfolio margined with positions in cash market securities or listed options.
- Hypothecation Requirements. Since Section 3E and proposed Rule 18a-4 will regulate the segregation of assets held as collateral in SBS transactions, a counterparty who has delivered collateral to a broker-dealer pursuant to an SBS transaction should be exempt from treatment as a “customer” for purposes of the hypothecation requirements in Section 8 and Rules 8c-1 and 15c2-1, except to the extent that the SBS is carried in a securities account and portfolio margined with positions in cash market securities or listed options. In addition, this exemption would provide consistency with the parallel exceptions from Rules 8c-1 and 15c2-1 for OTC derivatives dealers.
- Disclosure Requirements Relating to Extensions of Credit. Since SBS dealers and major SBS participants will be subject to disclosure requirements under Rule 15Fh-3(b) relating to the material terms of SBS, a broker-dealer that is also an SBS dealer or major SBS participant should, with respect to its SBS, be exempt from the disclosure requirements relating to terms and conditions of credit extensions in Rules 10b-16 and 15c2-5.
- Requirements relating to personnel of SBS dealers and major SBS participants. Since (a) Section 15F(b)(6) does not require associated persons of SBS dealers and major SBS participants to register with a national securities exchange or national securities association and (b) Congress did not add SBS dealers or major SBS participants to the lists of registrants subject to qualification requirements in Section 15(b)(7) or fingerprinting requirements in Section 17(f)(2), an SBS dealer or major SBS participant dually registered as a broker-dealer should be exempted from those sections and Rules 15b7-1 and 17f-2 thereunder with respect to its SBS.
- Research Requirements. Since SBS dealers and major SBS participants will be subject to separate research requirements in Section 15F(j)(5) and Rule 15Fh-3(h)(2)(I), an SBS dealer or major SBS participant dually registered as a broker-dealer should be exempted from Section 15D and Regulation AC with respect to “research reports” and “public appearances” that would only be treated as such because of information they contain relating to an SBS or an issuer of an SBS.
- Municipal Advisor Regulation. Consistent with the parallel exclusion for swap dealers in Rule 15Ba1-1(d)(2)(v), an SBS dealer or its associated person that is not acting as an advisor to a municipal entity, as set forth in Rule 15h-2, should be excluded or exempted from regulation as a municipal advisor.

- Securities Activities of OTC Derivatives Dealers. Rule 15a-1's limits on the securities dealing activities of OTC derivatives dealers are designed to distinguish OTC derivatives dealers from full-purpose broker-dealers. However, SBS dealing activities will be subject to the separate SBS dealer regulatory regime under Section 15F and rules thereunder, not the regime for broker-dealers. Accordingly, there should be an exemption from Rule 15a-1 for SBS. This exemption is necessary because, although most SBS are "eligible OTC derivatives instruments," currently some SBS are centrally cleared (and thus might be "fungible instruments that are standardized as to their material economic terms" within the meaning of Rule 3b-13(b)(2)(ii)) and some SBS might, in the future, be listed or traded on an exchange.
- Exchange Member SRO Membership. The exemption from membership in a registered securities association for certain exchange members in Rule 15b9-1 should be modified to not take into account transactions in SBS, since those transactions are subject to separate rules applicable to SBS dealers and major SBS participants, which are not required by Section 15(b)(8) to be members of a registered securities association.

#### Exceptions to Facilitate the Listing and Clearing of SBS

- Audit Committees and Compensation Committees. Consistent with their exceptions for security futures products and standardized options, Rules 10A-3 and 10C-1 should have exceptions covering the listing of SBS cleared by a registered clearing agency.