



December 20, 2018

Carol McGee
Assistant Director
Office of Derivatives Policy, Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Order Extending Until February 5, 2019, Certain Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of “Security” to Encompass Security-Based Swaps and Request for Comment (Release No. 34-82626; File No. S7-21-11)

Dear Ms. McGee:

This letter responds to the request by staff of the U.S. Securities and Exchange Commission (the “**Commission**”) that the Securities Industry and Financial Markets Association (“**SIFMA**”)¹ supplement our submission dated November 8, 2018 (the “**November 2018 Submission**”)² regarding the above-captioned release (the “**2018 Extension Order**”) by providing additional details regarding certain of the exemptions and guidance that we requested in that submission. In particular, we identify which of our requests related to Unlinked Temporary Exemptions (as defined below) and provide additional details regarding those requests. We also recommend a transition period before the expiration of any Unlinked Temporary Exemptions.

¹ SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our industry’s nearly 1 million employees, we advocate on legislation, regulation, and business policy, affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

² SIFMA, “Proposed Guidance and Exemptions to Clarify Treatment of Security-Based Swaps Under the Exchange Act” (Nov. 8, 2018), available at <https://www.sec.gov/comments/s7-27-11/s72711-4644757-176462.pdf>.

I. Background

In 2011, the Commission issued an order (the “**Exchange Act Exemptive Order**”)³ granting certain temporary exemptive relief (the “**Temporary Exemptions**”) in connection with the revision of the definition of “security” in the Securities Exchange Act of 1934 (“**Exchange Act**”) to encompass security-based swaps (“**SBSs**”). In 2014, the Commission issued an order (the “**2014 Extension Order**”)⁴ extending the expiration dates for the Temporary Exemptions. In the 2014 Extension Order, the Commission distinguished between: (i) the Temporary Exemptions related to pending SBS rulemakings (“**Linked Temporary Exemptions**”); and (ii) the Temporary Exemptions that generally were not directly related to a specific SBS rulemaking (“**Unlinked Temporary Exemptions**”). The expiration dates for the Linked Temporary Exemptions established by the 2014 Extension Order were the compliance dates for the specific rulemakings to which they were “linked,” and the expiration date for the Unlinked Temporary Exemptions was three years following the effective date of the 2014 Extension Order (*i.e.*, February 5, 2017), or such time that the Commission issues an order or rule determining whether continuing exemptive relief is appropriate for SBSs with respect to any such Unlinked Temporary Exemptions. In 2017, the Commission issued an order (the “**2017 Extension Order**”)⁵ extending the expiration date of the Unlinked Temporary Exemptions until February 5, 2018. The 2018 Extension Order then extended that expiration date until February 5, 2019.

II. SIFMA Requests Relating to Unlinked Temporary Exemptions

Below we identify which of our requests contained in the November 2018 Submission relate to Unlinked Temporary Exemptions and provide additional detail regarding those requests.⁶ We also discuss what transition period would be appropriate in connection with Unlinked Temporary Exemptions.

³ See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revisions of the Definition of “Security” to Encompass Security-Based Swaps, Exchange Act Release No. 64795 (July 1, 2011), 76 FR 39927 (July 7, 2011).

⁴ See Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of “Security” to Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 71485 (Feb. 5, 2014), 79 FR 7731 (Feb. 10, 2014) (extending the expiration date for certain Temporary Exemptions to February 5, 2017).

⁵ See Order Extending Certain Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of “Security” to Encompass Security-Based Swaps and Request for Comment, Exchange Act Release No. 79833 (Jan. 18, 2017), 82 FR 8467 (Jan. 25, 2017)

⁶ The November 2018 Submission also requested exemptions from the following provisions, which are currently covered by Linked Temporary Exemptions: Sections 5 and 6 of the Exchange Act; Regulation ATS; the “broker” and “dealer” registration requirements of Section 15(a)(1) of the Exchange Act and the other requirements of the Exchange Act and the rules and regulations thereunder that apply to a broker or dealer that is not registered with the Commission; Rule 10b-10 under the Exchange Act; Section 7 of the Exchange Act; and Regulation T. We may provide further information regarding these provisions and others covered by Linked Temporary Exemptions at a later date.

A. Exemptions to Provide Legal Certainty to the SBS Market

1. Regulation of SBS as Penny Stocks

Section 3(a)(51) of the Exchange Act and Rule 3a51-1 under the Exchange Act define a “penny stock” to mean an “equity security” that, among other things, has a price less than five dollars or has an issuer with less than a specified amount of net tangible assets or average revenue. Broker-dealers transacting in penny stocks are subject to enhanced disclosure and sales practice requirements under Rules 15g-1 through 15g-9 and Rule 15g-100 under the Exchange Act.

The Commission has not provided guidance regarding when an SBS would be subject to these rules. For example, it is not clear which SBSs constitute equity securities. It also is not clear whether, in classifying SBSs as penny stocks, market participants should evaluate the SBS itself or its underlier or, if the SBS itself is relevant, how to determine the “price” for an SBS that does not trade on a dollar price basis.

In addition, the requirements applicable to penny stocks under Rules 15g-1 through 15g-9 are designed to apply to cash market securities transactions, not over-the-counter SBSs. Moreover, SBSs will be subject to enhanced, SBS-specific disclosure and sales practice requirements as part of the Commission’s business conduct standards for SBS dealers and major SBS participants, making penny stock regulation duplicative.

To address these issues, the Commission should exempt SBSs between eligible contract participants from the definition of “penny stock.”

2. Regulation of SBS as Municipal or Government Securities

Section 3(a)(29) of the Exchange Act defines “municipal securities” to include, in relevant part, securities which are direct obligations of, or obligations guaranteed as to principal or interest by, specified municipal entities. Section 3(a)(42) of the Exchange Act, in turn, defines “government securities” to include, in relevant part, securities issued or guaranteed by certain corporations in which the United States has a direct or indirect interest and have been designated by the Secretary of the Treasury or issued or guaranteed by certain corporations the securities of which have been designated as exempt securities by Congress (any such corporation, a “**government-related corporation**”).⁷

Many of the municipal entities or government-related corporations whose securities generally fall within these definitions also participate in the SBS market. A technical question therefore arises as to whether SBSs entered into or guaranteed by such an entity or corporation would be considered municipal or government securities because they are securities which are direct obligations of, guaranteed by, or issued by such an entity or corporation. The consequences of

⁷ Section 3(a)(42) also covers securities which are direct obligations of, or obligations guaranteed as to principal or interest by, the United States. However, the issue noted below—categorization of SBSs with municipal or government-related entities—does not arise in connection with SBSs to which the United States government is a counterparty because Section 1a(47)(B)(ix) of the Commodity Exchange Act excludes contracts, agreements, or transactions with a counterparty that is the Federal Government, any Federal agency that is expressly backed by the full faith and credit of the United States, or a Federal Reserve bank from the “swap” definition and, correlatively, any such agreement, contract or transaction is not a “security-based swap.”

classifying such SBSs in this manner would include, among other things, subjecting the dealer counterparties to such municipal entities or government-related corporations to special regulation as municipal securities dealers or government securities dealers, respectively. Such regulation would, however, overlap with regulation of such dealers as SBS dealers—including the enhanced protections afforded to SBS dealers’ Special Entity counterparties, a category that would include (among others) municipal entities.

To address these issues, the Commission should provide guidance 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 entity or government-related corporation, respectively, should not be considered a municipal or government security solely due to the identity of the counterparty as a municipal entity or government-related corporation.⁸

We note that such guidance would not affect whether an SBS dealer or other person is subject to regulation as a municipal advisor because the “municipal advisor” definition covers a person who provides advice with respect to municipal financial products, in addition to a person providing advice with respect to the issuance of municipal securities.⁹ Municipal financial products include, among other products, SBSs to which a municipal entity is a counterparty.¹⁰

3. Section 31 Fees

When it originally proposed SBS reporting and public dissemination rules (“**Regulation SBSR**”) in 2010, the Commission noted that, when Regulation SBSR takes effect, SBSs will become subject to prompt last-sale reporting and, consequently, fees pursuant to Section 31(c) of the Exchange Act.¹¹ However, these Section 31 fees would only apply to SBS market participants who

⁸ We note that, in the government securities context, such guidance would be consistent with the fact that the relevant designations by the Secretary of the Treasury or Congress typically reference securities issued under specific legislation (e.g., the Farm Credit Act, the Federal Home Loan Bank Act, or the National Housing Act) or specific types of securities (e.g., securities issued by a multilateral development bank for capital raising purposes) that would not typically cover SBSs. With respect to municipal securities, the Commission could, as an alternative to this guidance, exercise its exemptive authority pursuant to Section 36 of the Exchange Act to exempt SBS counterparties to municipal entities from registration and regulation as municipal securities dealers in connection with such SBSs.

⁹ See Section 15B(e)(4)(i) of the Exchange Act.

¹⁰ See Rule 15Ba1-1(g) under the Exchange Act.

¹¹ Specifically, the Commission explained, “Section 31(c) of the Exchange Act provides that a national securities association must pay fees based on the ‘aggregate dollar amount of sales transacted by or through any member of such association otherwise than on a national securities exchange of securities * * * registered on a national securities exchange or subject to prompt last sale reporting pursuant to the rules of the Commission or a registered national securities association.’ Pursuant to Section 761(a) of the Dodd-Frank Act, SBSs are securities. When proposed Regulation SBSR becomes effective, SBSs will be subject to prompt last-sale reporting pursuant to the rules of the Commission because they will be subject to real-time public dissemination. Therefore, a national securities association the members of which effect SBS sales other than on an exchange (including on a SB [swap execution facility]) would be liable for Section 31 fees for any such sales. A national securities association typically obtains funds to pay its Section 31 fees by imposing on its members an offsetting fee on covered sales, and would likely take the same approach with respect to SBSs.” See Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 63346 (Nov. 19, 2010), 75 FR 75208, 75245 (Dec. 2, 2010) (citations omitted).

are members of a national securities association (*e.g.*, SBS brokers, as well as the subset of SBS dealers dually registered as broker-dealers), which would only comprise a relatively small portion of SBS market participants.¹² Accordingly, to establish a level playing field and avoid undue burdens on this subset of the market, the Commission proposed to amend Rule 31(a) under the Exchange Act to exempt SBS from calculation of Section 31 fees.¹³

When the Commission adopted Regulation SBSR in 2015, however, it declined to adopt this exemption because final Regulation SBSR does not yet require that SBS transactions be publicly disseminated in real-time, and thus sales of SBSs are not yet subject to Section 31 fees.¹⁴ Although we agree with the Commission's interpretation, in our view it would still be appropriate for the Commission to finalize its exemption of SBSs from Section 31 prior to the initial compliance date for Regulation SBSR. The rationale for the exemption set forth by the Commission in 2010 continues, and will continue, to apply; delaying adoption of the exemption will only foster uncertainty in the SBS market by leaving the ultimate Section 31 treatment of SBSs unclear.

B. Exemptions to Account for SBS-Specific Regulation

1. Hypothecation Requirements

Section 8 of the Exchange Act and Rules 8c-1 and 15c2-1 under the Exchange Act impose certain limits on a broker-dealer's hypothecation of securities carried for the account of a customer, which work in tandem with the customer protection requirements in Section 15(c)(3) of the Exchange Act and Rule 15c3-3 thereunder.

The Commission has identified its exemptions of SBS from Section 15(c)(3) and Rule 15c3-3 as Linked Temporary Exemptions, which are linked to the compliance date of final capital, margin and segregation requirements for SBS dealers and major SBS participants. Due to the shared purpose and relationship between Section 15(c)(3) and Rule 15c3-3, on one hand, and Section 8 and Rules 8c-1 and 15c2-1, on the other hand, the Commission should similarly extend the exemptions of SBSs from Section 8 and Rules 8c-1 and 15c2-1 until the compliance date of final capital, margin and segregation requirements for SBS dealers and major SBS participants. The Commission should also address the application of Section 8 and Rules 8c-1 and 15c2-1 to SBSs as part of finalizing those capital, margin and segregation requirements.¹⁵

2. Disclosure Requirements Relating to Extensions of Credit

Rules 10b-16 and 15c2-5 under the Exchange Act impose certain disclosure and information gathering requirements on broker-dealers extending credit in connection with securities transactions.

¹² *See id.*

¹³ *See id.*

¹⁴ *See* Regulation SBSR-Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 74244 (Feb. 11, 2015), 80 FR 14563, 14673 (Mar. 19, 2015).

¹⁵ For additional details regarding our proposal regarding the application of segregation and customer protection requirements to SBSs, see our recent comment letter in response to the Commission's re-opened comment period regarding capital, margin and segregation requirements for SBS dealers and major SBS participants, available at <https://www.sec.gov/comments/s7-08-12/s70812-4663163-176543.pdf>.

These requirements generally pertain to traditional loans (including margin loans) and include several provisions that are inapposite to SBS (*e.g.*, disclosures regarding interest rates and debit balances). In addition, SBS dealers will be subject to SBS-specific disclosure and information gathering (“know your counterparty”) requirements as part of the SBS dealer business conduct standards reflected in Rule 15Fh-3 under the Exchange Act, thus making Rules 10b-16 and 15c2-5 duplicative for SBSs.

To address these issues, the Commission should extend the exemptions of SBSs from Rules 10b-16 and 15c2-5 until the compliance date for SBS dealer business conduct standards and, thereafter, should apply those exemptions permanently to a broker-dealer that is also an SBS dealer or engaged in *de minimis* SBS dealing activity.

3. Requirements Relating to Personnel of SBS Dealers and Major SBS Participants

Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder require natural persons associated with broker-dealers who effect securities transactions to satisfy qualification requirements of self-regulatory organizations (“SROs”). In contrast, Section 15F(b)(6) of the Exchange Act does not require associated persons of SBS dealers or major SBS participants to register with any SRO. Nor did Congress add SBS dealers or major SBS participants to the list of registrants whose associated persons are subject to qualification requirements in Section 15(b)(7). And no SRO has adopted qualification requirements relating to SBSs.

Section 17(f)(2) of the Exchange Act and Rule 17f-2 thereunder requires partners, directors, officers, and employees of specified Commission registrants (including broker-dealers) and members of national securities exchanges who are involved in securities-related activities to be fingerprinted for background check purposes. Congress did not, however, add SBS dealers or major SBS participants to the list of registrants subject to Section 17(f)(2).

So as to avoid unequal application of these requirements to broker-dealers engaged in SBS dealing activity relative to other SBS dealers, the Commission should extend the exemptions of SBSs from Sections 15(b)(7) and 17(f)(2) of the Exchange Act and Rules 15b7-1 and 17f-2 thereunder until the compliance date of registration requirements for SBS dealers and major SBS participants and, thereafter, should apply those exemptions permanently to broker-dealers that are also SBS dealers or engaged in *de minimis* SBS dealing activity, in each case with respect to their partners, directors, officers, and employees whose only securities-related activities involve SBSs.

4. Securities Activities of OTC Derivatives Dealers

So as to distinguish OTC derivatives dealers from full-purpose broker-dealers, Rule 15a-1 under the Exchange Act limits the securities dealing activities of OTC derivatives 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, the Commission should extend its exemption of SBSs from Rule 15a-1 until the compliance date of registration requirements for SBS dealers and major SBS participants and, thereafter, should permanently exempt SBSs from Rule 15a-1 for SBS. This exemption is necessary because, although most SBSs are “eligible OTC derivatives instruments,” currently some SBSs 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 SBSs might, in the future, be listed or traded on an exchange.

5. Exchange Member SRO Membership

Rule 15b9-1 under the Exchange Act provides an exemption from membership in a registered securities association for certain exchange members engaged in a limited amount of off-exchange transactions. The Commission should extend the exemption of SBSs from Rule 15b9-1 until the compliance date of registration requirements for SBS dealers and major SBS participants and, thereafter, should modify Rule 15b9-1 to not take into account transactions in SBSs, 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.

C. Exemptions to Facilitate the Listing and Clearing of SBS

Rules 10A-3 and 10C-1 under the Exchange Act currently contain exceptions from audit and compensation committee requirements in connection with clearing agencies as issuers of security futures products and standardized options. Given the similarities of cleared SBSs to these products, the Commission should amend these rules to include exceptions covering the listing of SBSs cleared by a registered clearing agency.

D. Transition Period

In order to provide an appropriate transitional period to the treatment of SBSs as securities under the Exchange Act and rules thereunder, including the application or potential application of well over 150 different provisions not covered by the exemption requests set forth above, the Commission should extend the Unlinked Temporary Exemptions for another 12 months. During this transition period, market participants will further analyze the applicability of these provisions to their SBS business and design and implement appropriate compliance measures, including, where relevant, controls designed to prevent or detect activity that might potentially trigger these provisions. Absent such a compliance period, market participants would not have sufficient time to put these compliance measures in place and might need to curtail their SBS activity until they are able to do so.

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Please feel free to reach out to the undersigned should you have any questions.

Sincerely,



Kyle Brandon
Managing Director, Head of Derivatives
SIFMA