

August 13, 2015

SEC Moves Closer to Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Americas

Geoffrey B. Goldman
New York
+1.212.848.4867
geoffrey.goldman@shearman.com

Donald N. Lamson
Washington, DC
+1.202.508.8130
donald.lamson@shearman.com

Russell D. Sacks
New York
+1.212.848.7585
rsacks@shearman.com

Donna M. Parisi
New York
+1.212.848.7367
dparisi@shearman.com

Bradley K. Sabel
New York
+1.212.848.8410
bsabel@shearman.com

Reena Agrawal Sahni
New York
+1.212.848.7324
reena.sahni@shearman.com

Azam H. Aziz
New York
+1.212.848.8154
aaziz@shearman.com

Jason D. White
New York
+1.212.848.5259
jason.white@shearman.com

On August 5, 2015, the US Securities and Exchange Commission (“SEC”) took several incremental steps toward completing its regulatory framework for security-based swap dealers and majority security-based swap participants (“SBS Entities”). The SEC unanimously adopted final rules (the “Final Rules”) providing the registration process for SBS Entities, including the detailed forms that registrants will be required to file.¹ The SEC also voted 3-2 to propose rules to establish a process for an SBS Entity to apply for permission to continue to have associated persons for security-based swap activity that are subject to statutory disqualification (the “Disqualification Waiver Process”).

When Will Registration Be Required?

Registration requirements for SBS Entities² will not immediately go into effect. The Final Rules provide a compliance date for the registration requirement (the “Registration

¹ See draft final rules on the SEC website available at: <http://www.sec.gov/rules/final/2015/34-75611.pdf>.

² The SEC has adopted two other significant final rules relating to SBS Entities: See SEC/CFTC joint final rules on the Definitions of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” 77 FR 30596 (May 23, 2012), available at: <http://www.gpo.gov/fdsys/pkg/FR-2012-05-23/pdf/2012-10562.pdf>. See SEC final rules for the Application of “Security-Based Swap Dealer” and “Major Security-Based Swap Participant” Definitions to Cross-Border Security-Based Swap Activities, 79 FR 47278 (August 12, 2014), available at: <http://www.gpo.gov/fdsys/pkg/FR-2014-08-12/pdf/R1-2014-15337.pdf>.

Contacts (cont.)

Bjorn Bjerke
New York
+1.212.848.4607
bjorn.bjerke@shearman.com

London

Barney Reynolds
London
+44.20.7655.5528
barney.reynolds@shearman.com

Thomas Donegan
London
+44.20.7655.5566
thomas.donegan@shearman.com

Bill Murdie
London
+44.20.7655.5149
bill.murdie@shearman.com

Azad Ali
London
+44.20.7655.5659
azad.ali@shearman.com

John Adams
London
+44.20.7655.5740
john.adams@shearman.com

Kolja Stehl
London
+44.20.7655.5864
kolja.stehl@shearman.com

Aatif Ahmad
London
+44.20.7655.5120
aatif.ahmad@shearman.com

SHEARMAN.COM

Compliance Date”) that will be the latest of:

- six months after publication of final rules establishing capital, margin and segregation requirements for SBS Entities;
- the compliance date for final rules establishing recordkeeping and reporting requirements for SBS Entities;
- the compliance date of final rules establishing business conduct requirements for SBS Entities; and
- the compliance date for final rules establishing a Disqualification Waiver Process.

The ultimate timing of the Registration Compliance Date thus remains uncertain and depends on further rulemakings by the SEC.³

The Final Rules also provide that potential SBS Entities will not need to start calculating whether their activities may exceed the relevant registration thresholds until two months prior to the Registration Compliance Date (the “SBS Entity Counting Date”). As a result, security-based swap activity prior to the SBS Entity Counting Date need not be counted toward the security-based swap dealer de minimis threshold or the test for major security-based swap participant status. In the adopting release, the SEC acknowledged that as a result, some security-based swap dealer entities may not be required to register for a year following the SBS Entity Counting Date, depending on activity levels.

SBS Entity Registration Process

Under the Final Rules, the SEC will grant an SBS Entity conditional registration status once it has filed an application with the SEC and provided the required senior officer certifications (discussed below). The SEC will then review the application to either grant ongoing registration or institute proceedings to deny registration of the SBS Entity. As part of the registration process, SBS Entities will be required to submit extensive information about their business activities, structure and background as well as information about their control affiliates.

To register, an SBS Entity must electronically file the appropriate version of Form SBSE through the SEC’s EDGAR system.⁴ The Final Rules provides a choice of three forms—Form SBSE, Form SBSE-A or Form SBSE-BD—depending on whether the SBS Entity is already registered with the SEC as a broker-dealer and/or with the US Commodity Futures Trading Commission (“CFTC”) as a swap dealer or major swap participant. Under

³ CFTC registration for Swap Dealers and Major Swap Participants was required by December 31, 2012 (See CFTC FAQs confirming this timing, available at: <http://www.cftc.gov/PressRoom/PressReleases/pr6348-12>.)

⁴ Unlike broker-dealer registration, SBS Entity registration applications will not be filed with or processed by FINRA.

this approach, certain information need not be provided for entities that are already registered with the SEC and/or CFTC in these capacities. The registration form appears to be based to a great extent on the Form BD used for broker-dealer registration.

The Final Rules also require amendments by an SBS entity when registration information becomes inaccurate, and provide a mechanism for withdrawal of an SBS entity from registration and cancellation or revocation of registration of an SBS entity by the SEC in specified cases.

Senior Officer Certification

As part of the application, the Final Rules require two certifications of senior officers that the SBS Entity is meeting applicable requirements.

First, a senior officer⁵ must certify that he or she has determined that the applicant has financial, operational and compliance rules and procedures in place to act as a security-based swap dealer or major security-based swap participant. The officer must also certify that he or she has documented the process for reaching such determination.

Second, the Chief Compliance Officer (“CCO”), or his or her selected designee, must certify that he or she has performed background checks on associated persons who are individuals and who effect or are involved in effecting security-based swaps. The CCO or designee must further certify that he or she neither knows, nor in exercising reasonable care should have known, that any such associated person is subject to a statutory disqualification, unless a specific exception applies (see below).

Notably, similar certification requirements have not been adopted by the CFTC for the registration of swap dealers and major swap participants under its jurisdiction.

Registration for Non-US SBS Entities

The Final Rules impose additional requirements on a so-called “nonresident SBS Entity” (an SBS entity incorporated or having its principal place of business outside the US) that seeks to register. In addition to the requirements for SBS Entities, such an entity would have to:

- appoint a US agent for service of process;
- certify that the entity can, as a matter of law, and will provide the SEC with prompt access to its books and records and submit to onsite SEC examinations and inspections; and
- provide an opinion of counsel that the entity can, as a matter of law, provide the SEC with prompt access to its books and records and submit to onsite SEC examinations and inspections.

It is not clear to what extent these requirements will, in practice, be an obstacle for non-US entities to register as SBS Entities. In the comment process, concerns were expressed about the impact of restrictions on sharing of information under the laws of some jurisdictions. Nonetheless, the SEC was unwilling to rely solely on information sharing arrangements with foreign regulators in this regard and insisted on full direct access. It also bears noting that there is no corresponding opinion requirement in the CFTC registration process for swap dealers and major swap participants.

⁵ A senior officer for this purpose would be a senior executive such as the chief executive officer, chief financial officer, chief legal officer, chief compliance officer, president or similar person, in any case who has the legal authority to bind the applicant.

Non-US market participants may need to consider the appropriate structure for their US security-based swap activity in light of these requirements.

Disqualification Waiver Process

The Exchange Act generally prohibits an SBS Entity from having an associated person that is subject to statutory disqualification.⁶ The SEC voted 3-2 to issue proposed rules (“Proposed Rules”) which would permit a registered SBS Entity to apply to the SEC for an order permitting the SBS Entity to allow associated persons (whether the person is a natural person or entity) subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity, based on a showing that such association is nonetheless consistent with the public interest.⁷ Further, the Proposed Rules would allow associated entities (but not natural persons) that are statutorily disqualified to continue effecting security-based swaps activities on behalf of the SBS Entity for a certain period of time as the SEC continues to evaluate the SBS Entity’s application.

Comments on the Proposed Rules are due 60 days after publication in the Federal Register.

The SEC is requesting comment on a number of issues, including whether:

- the Proposed Rules should apply the general prohibition on association to disqualified natural persons only and not entities;
- the proposed time period for temporary relief currently set at 180 days is the appropriate time period to avoid disruptions in business; and
- the SEC should have to disqualify a business already disqualified by the CFTC or other regulators.

In order to avoid disruption in the markets, the Final Rules also provide for a limited exception allowing new registered SBS Entities to associate with persons subject to a statutory disqualification, if (1) the associated persons are not natural persons and (2) the statutory disqualification(s) occurred prior to the Registration Compliance Date. SBS Entities must identify such associated persons on registration forms.

⁶ See Securities Exchange Act of 1934 (the “Exchange Act”) on the SEC website available at: <http://www.sec.gov/about/laws/sea34.pdf>.

⁷ See draft proposed on the SEC website, available at: <http://www.sec.gov/rules/proposed/2015/34-75612.pdf>. Such an order would, in effect, be similar to waivers of the disqualification that the SEC may provide for other registration categories.

Conclusion

The Final Rules and Proposed Rules outline a more definitive process under which SBS Entities will be required to register, although the actual registration will not commence until several additional rulemakings by the SEC are completed. In the interim, potential SBS Entities that are non-US entities may want to consider whether they can satisfy the SEC's requirements as to information-sharing, or alternatively, whether alternative structures for US security-based swap businesses may be needed. Potential SBS Entities may also need to consider the impact of potential disqualification issues for their associated persons in light of the Proposed Rules.

BU DHABI | BEIJING | BRUSSELS | FRANKFURT | HONG KONG | LONDON | MENLO PARK | MILAN | NEW YORK | PARIS
ROME | SAN FRANCISCO | SÃO PAULO | SAUDI ARABIA* | SHANGHAI | SINGAPORE | TOKYO | TORONTO | WASHINGTON, DC

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069

Copyright © 2015 Shearman & Sterling LLP. Shearman & Sterling LLP is a limited liability partnership organized under the laws of the State of Delaware, with an affiliated limited liability partnership organized for the practice of law in the United Kingdom and Italy and an affiliated partnership organized for the practice of law in Hong Kong.

*Abdulaziz Allassaf & Partners in association with Shearman & Sterling LLP