

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PARTS 230, 240 and 260**

**[Release Nos. 33-9231; 34-64794; 39-2475; File No. S7-26-11]**

**RIN 3235-AL17**

**EXEMPTIONS FOR SECURITY-BASED SWAPS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Interim final rules; request for comments.

**SUMMARY:** We are adopting interim final rules providing exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for those security-based swaps that under current law are security-based swap agreements and will be defined as “securities” under the Securities Act and the Exchange Act as of July 16, 2011 due solely to the provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The interim final rules will exempt offers and sales of these security-based swaps from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provisions, as well as exempt these security-based swaps from Exchange Act registration requirements and from the provisions of the Trust Indenture Act, provided certain conditions are met. The interim final rules will remain in effect until the compliance date for final rules that we may adopt further defining the terms “security-based swap” and “eligible contract participant.”

**DATES:** Effective Date: The interim final rules are effective [insert date of publication in the Federal Register]. Comments should be received on or before August 15, 2011].

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/interim-final-temp.shtml>);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-26-11 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-26-11. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/interim-final-temp.shtml>). Comments also are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Andrew Schoeffler, Special Counsel, Office of Capital Market Trends, Division of Corporation Finance, at (202) 551-3860, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** We are adopting interim final Rule 240 under the Securities Act of 1933 (“Securities Act”),<sup>1</sup> interim final Rule 12a-11 and Rule 12h-1(i) under the Securities Exchange Act of 1934 (“Exchange Act”),<sup>2</sup> and interim final Rule 4d-12 under the Trust Indenture Act of 1939 (“Trust Indenture Act”).<sup>3</sup>

## **I. BACKGROUND**

On July 21, 2010, President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) into law.<sup>4</sup> The Dodd-Frank Act was enacted, among other reasons, to promote the financial stability of the United States by improving accountability and transparency in the financial system.<sup>5</sup> The recent financial crisis demonstrated the need for enhanced regulation of the over-the-counter (“OTC”) derivatives markets, which have experienced dramatic growth in recent years<sup>6</sup> and are capable of affecting significant sectors of the U.S. economy.<sup>7</sup> Title VII of the Dodd-Frank Act (“Title VII”) establishes a regulatory regime applicable to the OTC derivatives markets by providing the Securities and Exchange Commission (“Commission” or “we”) and the Commodity Futures Trading Commission (“CFTC”) with the tools to oversee these heretofore largely unregulated markets. Title VII provides that the CFTC will regulate “swaps,” the Commission will regulate

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<sup>1</sup> 15 U.S.C. 77a et. seq.

<sup>2</sup> 15 U.S.C. 78a et. seq.

<sup>3</sup> 15 U.S.C. 77aaa et. seq.

<sup>4</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>5</sup> See, e.g., Pub. L. No. 111-203, Preamble.

<sup>6</sup> From their beginnings in the early 1980s, the notional value of these markets has grown to almost \$600 trillion globally. See Monetary and Econ. Dep’t, Bank for Int’l Settlements, Triennial and Semiannual Surveys – Positions in Global Over-the-Counter (OTC) Derivatives Markets at End-June 2010 (Nov. 2010), available at [http://www.bis.org/publ/otc\\_hy1011.pdf](http://www.bis.org/publ/otc_hy1011.pdf).

<sup>7</sup> See 156 Cong. Rec. S5878 (daily ed. July 15, 2010) (statement of Sen. Dodd).

“security-based swaps,” and the CFTC and the Commission will jointly regulate “mixed swaps.”<sup>8</sup>

Title VII amends the Securities Act and the Exchange Act to substantially expand the regulation of the security-based swap markets, establishing a new regulatory framework within which such markets can continue to evolve in a more transparent, efficient, fair, accessible, and competitive manner.<sup>9</sup> The Title VII amendments to the Exchange Act impose, among other requirements, the following: (1) registration and comprehensive oversight of security-based swap dealers and major security-based swap participants;<sup>10</sup> (2) reporting of security-based swaps to a registered security-based swap data repository, to the Commission, and to the public;<sup>11</sup> (3) clearing of security-based swaps through a registered clearing agency or through a clearing

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<sup>8</sup> Section 712(d) of the Dodd-Frank Act provides that the Commission and the CFTC, in consultation with the Board of Governors of the Federal Reserve System, shall further define the terms “swap,” “security-based swap,” “swap dealer,” “security-based swap dealer,” “major security-based swap participant,” “eligible contract participant,” and “security-based swap agreement.” These terms are defined in sections 721 and 761 of the Dodd-Frank Act and the Commission and the CFTC have proposed to further define these terms in proposed joint rulemaking. See Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, Release No. 34-63452 (Dec. 7, 2010), 75 FR 80174 (Dec. 21, 2010)(“SBS Participant Definition Proposing Release”); and Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Release No. 33-9204 (Apr. 29, 2011), 76 FR 29818 (May 23, 2011), corrected in Release No. 33-9204A (June 1, 2011), 76 FR 32880 (June 7, 2011)(“SBS Product Definition Proposing Release”).

<sup>9</sup> See generally subtitle B of Title VII.

<sup>10</sup> See section 15F of the Exchange Act, 15 U.S.C. 78o-10.

<sup>11</sup> See section 3(a)(75) of the Exchange Act, 15 U.S.C. 78c(a)(75) (defining the term “security-based swap data repository”). See also Security-Based Swap Data Repository Registration, Duties, and Core Principles, Release No. 34-63347 (Nov. 19, 2010), 75 FR 77306 (Dec. 10, 2010); corrected at 75 FR 79320 (Dec. 20, 2010) and 76 FR 2287 (Jan. 13, 2011)(proposed rules); and Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, Release No. 34-63346 (Nov. 19, 2010), 75 FR 75208 (Dec. 2, 2010) (proposed rules).

agency that is exempt from registration<sup>12</sup> if such security-based swaps are of a type that the Commission determines is required to be cleared, unless an exemption or exception from such mandatory clearing applies;<sup>13</sup> and (4) if a security-based swap is subject to the clearing requirement,<sup>14</sup> execution of the security-based swap transaction on an exchange, on a security-based swap execution facility (“security-based SEF”) registered under the Exchange Act,<sup>15</sup> or on a security-based SEF that has been exempted from registration by the Commission under the Exchange Act,<sup>16</sup> unless no security-based SEF or exchange makes such security-based swap available for trading.<sup>17</sup> Title VII also amends the Securities Act and the Exchange Act to include “security-based swaps” in the definition of “security” for purposes of those statutes.<sup>18</sup> As a result, “security-based swaps” will be subject to the provisions of the Securities Act and the Exchange Act and the rules thereunder applicable to “securities.”

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<sup>12</sup> See subparagraphs (i) and (j) to Section 17A of the Exchange Act, 15 U.S.C. 78q-1. See also Clearing Agency Standards for Operation and Governance, Release No. 34-64017 (Mar. 3, 2011), 76 FR 14472 (Mar. 16, 2011)(proposed rules).

<sup>13</sup> See section 3C(a)(1) of the Exchange Act, 15 U.S.C. 78c-3(a)(1). See also Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations, Release No. 34-63557 (Dec. 15, 2010), 75 FR 82490 (Dec. 30, 2010)(proposed rules).

<sup>14</sup> See section 3C(g) of the Exchange Act, 15 U.S.C. 78c-3(g) (providing an exception to the clearing requirement for certain persons).

<sup>15</sup> 15 U.S.C. 78c-4.

<sup>16</sup> 15 U.S.C. 78c-4(e).

<sup>17</sup> See section 3C(g) of the Exchange Act, 15 U.S.C. 78c-3(g). See section 3C(h) of the Exchange Act, 15 U.S.C. 78c-3(h). See also section 3(a)(77) of the Exchange Act, 15 U.S.C. 78c(77) (defining the term “security-based swap execution facility”). See also Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011)(“Security-Based SEF Proposing Release”).

<sup>18</sup> See sections 761(a)(2) and 768(a)(1) of the Dodd-Frank Act (amending sections 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10), and 2(a)(1) of the Securities Act, 15 U.S.C. 77b(a)(1), respectively).

The provisions of Title VII generally are effective on July 16, 2011 (360 days after enactment of the Dodd-Frank Act, the “Effective Date”), unless a provision requires a rulemaking. Specifically, if a Title VII provision requires a rulemaking, it will go into effect “not less than” 60 days after publication of the related final rule or on July 16, 2011, whichever is later.<sup>19</sup> We do not expect to complete all of the rulemaking we are directed to carry out pursuant to the provisions of Title VII prior to the Effective Date.

We have proposed to further define and provide guidance regarding the terms “security-based swap”<sup>20</sup> and “eligible contract participant.”<sup>21</sup> These proposed rules are among the rulemakings that will not be adopted by the Effective Date. We recognize that until we further define such terms, market participants may be uncertain as to how to comply with the applicable registration requirements of the Securities Act, the registration requirements of the Exchange Act applicable to classes of securities, and the indenture provisions of the Trust Indenture Act. In that regard, a number of commenters recently have raised concerns about potential uncertainty regarding the definitions of “security-based swap” and “eligible contract participant” and the

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<sup>19</sup> See Section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note. As we noted in our recent Order Pursuant to Sections 15F(b)(6) and 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, and Request for Comment, Release No. 34-64678 (June 15, 2011)(“Effective Date Order”), the effective date of certain provisions or requirements may require other Commission actions before the parties can comply with mandated obligations.

<sup>20</sup> See SBS Product Definition Proposing Release, supra note 8.

<sup>21</sup> See SBS Participant Definition Proposing Release, supra note 8. The term “eligible contract participant” currently is defined in Section 1a(12) of the Commodity Exchange Act (7 U.S.C. 1a(12)). For purposes of transactions in security-based swap agreements, “eligible contract participant” is defined by reference to such section as in effect on the date of enactment of the Commodity Futures Modernization Act (Pub. L. No. 106-554, 114 Stat. 2763 (2000)) and does not include any person determined by the CFTC to be an eligible contract participant pursuant to their authority in Section 1a(12)(C) of the Commodity Exchange Act (7 U.S.C. 1a(12)). Title VII amended the definition of “eligible contract participant” to narrow in some respects the definition of eligible contract participant in Section 1a(12). See footnote 38, supra.

related proposed rulemakings.<sup>22</sup> As part of our recent action providing guidance as to which of the requirements of Title VII will apply to security-based swap transactions as of the Effective Date and granting temporary relief to market participants from compliance with certain of these requirements, we granted certain temporary exemptions relating to security-based swap transactions with persons who are eligible contract participants as that term is defined today and relating to the operation of trading platforms for security-based swaps.<sup>23</sup> The exemption relating to eligible contract participants will allow persons currently participating in the security-based swap markets, who could potentially be considered non-eligible contract participants under the definition of “eligible contract participant” as amended by Title VII, to continue to do so until the term “eligible contract participant” is further defined in final rulemaking.<sup>24</sup> We also provided a temporary exemption to allow an entity that trades security-based swaps and is not currently registered as a national securities exchange or that cannot yet register as a security-based SEF because final rules for such registration have not yet been adopted, to continue trading

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<sup>22</sup> See, e.g., Letter from American Bankers Association, Financial Services Roundtable, Futures Industry Association, Institute of International Bankers, International Swaps and Derivatives Association, Investment Company Institute, Securities Industry and Financial Markets Association, U.S. Chamber of Commerce (June 10, 2011)(“Trade Association Letter”). (“The definition of [eligible contract participant] was amended by [the Dodd-Frank Act], and the [Commission and the CFTC] have sought comments in [the SBS Participant Definition Proposing Release] on how to further define such term, including how to interpret the phrase “discretionary basis.” Until the term [eligible contract participant] is further defined in a final rulemaking, market participants will not know whether they are dealing with an [eligible contract participant], and where the line is between their institutional and retail businesses. As a result, they will not know . . . whether certain transactions are subject to the new requirement for [non-eligible contract participant] transactions to be executed on an exchange . . . . As a result, market participants may cease or severely limit their business with counterparties that could potentially be considered [non-eligible contract participants] under the Dodd-Frank statutory definition of [eligible contract participant].”).

<sup>23</sup> See Effective Date Order, supra note 19.

<sup>24</sup> See Id.

security-based swaps during this temporary period without registering as a national securities exchange or security-based SEF.<sup>25</sup>

In addition to the matters addressed in our recent action, we understand that there are other implications for security-based swaps under the Securities Act, other provisions of the Exchange Act, and the Trust Indenture Act. As we note, we have received comments expressing concern regarding the implications of including security-based swaps in the definition of “security.” Commenters have indicated that they are still analyzing the full implications of such expansion of the definition of “security,” but that it will take time. Market participants therefore have requested temporary relief from certain provisions of the Securities Act and the Exchange Act so that parties may complete their analysis and submit requests for more targeted relief.<sup>26</sup>

While we recently proposed exemptions under the Securities Act, the Exchange Act and the Trust Indenture Act for security-based swaps issued by certain clearing agencies in their function as central counterparties (CCP) under certain conditions (the “Proposed SBS Exemptions”)<sup>27</sup> and also recently extended our temporary rules that provided certain exemptions under the Securities Act, the Exchange Act and the Trust Indenture Act for cleared credit default swaps (the “Temporary CDS Rules”),<sup>28</sup> these exemptions would not apply to transactions in

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<sup>25</sup> See Id.

<sup>26</sup> See Trade Association Letter, supra note 22.

<sup>27</sup> See Exemptions For Security-Based Swaps Issued By Certain Clearing Agencies, Release No. 33-9222 (June 9, 2011), 76 FR 34920 (June 15, 2011) (“SBS Exemptions Proposing Release”). The proposed exemptions would exempt transactions by clearing agencies in security-based swaps from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provisions, as well as exempt these security-based swaps from Exchange Act registration requirements and from the provisions of the Trust Indenture Act, provided certain conditions are met.

<sup>28</sup> See Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps, Release No. 33-8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009); Extension of Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps, Release No. 33-9063 (Sep. 14, 2009), 74 FR 47719 (Sep. 17, 2009); and Extension of Temporary



security-based swaps, including credit default swaps, not involving a clearing agency. We also note that while the Temporary CDS Rules will be in place on the Effective Date, the Proposed SBS exemptions will not.

As a result, because security-based swaps will become securities on the Effective Date, absent the action we take in this release, counterparties entering into transactions in security-based swaps that are not within the scope of the Temporary CDS Rules will either need to rely on other available exemptions from the requirements of the Securities Act, the Exchange Act, and, if applicable, the Trust Indenture Act, or to consider whether to register such transactions or class of security.<sup>29</sup>

We note that under current law, certain security-based swaps – specifically those within the pre-Dodd-Frank Act definition of “security-based swap agreement” entered into between eligible contract participants and subject to individual negotiation – are outside the scope of the federal securities laws, other than the anti-fraud and certain other provisions.<sup>30</sup> Up until now, these security-based swaps have been traded or otherwise transacted without concerns about complying with the registration requirements of the Securities Act, the registration requirements of the Exchange Act applicable to classes of securities, or the indenture provisions of the Trust Indenture Act. We understand that there are several types of trading platforms currently being used to effect transactions in security-based swaps that would likely register as security-based

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Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps, Release No. 33-9158 (Nov. 19, 2010), 75 FR 72660 (Nov. 26, 2010).

<sup>29</sup> See SBS Exemptions Proposing Release, supra note 27.

<sup>30</sup> See Section 2A of the Securities Act (15 U.S.C. 77b(b)-1) and Section 3A of the Exchange Act (15 U.S.C. 78c-1). The definition of “security-based swap agreement” includes the definition of “swap agreement,” which requires that the agreement, contract or transaction be “subject to individual negotiation” and be between eligible contract participants.

SEFs,<sup>31</sup> and that this activity would continue after the Effective Date.<sup>32</sup> We understand that if parties continue to engage in the same types of trading activities after the Effective Date that they may be engaging in currently with respect to security-based swap agreements that may be security-based swaps on the Effective Date, such activities may raise concerns about the availability of an exemption from the registration requirements of the Securities Act, such as the private placement exemption in Securities Act Section 4(2).<sup>33</sup>

We have recognized that implementation of the Title VII provisions raises issues in a number of contexts. As we noted in our recent action, in furtherance of the Dodd-Frank Act's stated objective of promoting financial stability in the U.S. financial system, we intend to move forward expeditiously with the implementation of the new security-based swap requirements in an efficient manner, while minimizing unnecessary disruption and costs to the markets.<sup>34</sup> We recognize that many market participants will find compliance with Title VII to be a substantial undertaking. Security-based swap markets already exist, are global in scope, and have generally grown in the absence of regulation in the United States and elsewhere. In addition, the security-based swap markets are interconnected with other financial markets, including the traditional securities markets. In order to comply with Title VII provisions and related rules, we recognize that market participants will need additional time to acquire and configure necessary systems or to modify existing practices and systems, engage and train necessary staff, and develop and

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<sup>31</sup> See Security-Based SEF Proposing Release, supra note 17. As we note above, we recently addressed certain issues relating to these trading platforms pending adoption of rules relating to security-based SEFs. See Effective Date Order, supra note 19.

<sup>32</sup> We requested comment on these issues in the SBS Exemptions Proposing Release. See SBS Exemptions Proposing Release, supra note 27.

<sup>33</sup> 15 U.S.C. 77d(2). Section 4(2) provides an exemption from registration for transactions by an issuer not involving any public offering.

<sup>34</sup> See Effective Date Order, supra note 19.

implement necessary policies and procedures. Furthermore, some of these changes cannot be undertaken until certain rules are finalized.

We are concerned about disrupting the operation of the security-based swap markets until the compliance date for final rules that we may adopt further defining the terms “security-based swap” and “eligible contract participant.” In our view, it is appropriate to permit those security-based swap transactions that, prior to the Effective Date, would be transactions in security-based swap agreements between eligible contract participants (and, therefore, not subject to the registration requirements of the Securities Act, the registration requirements of the Exchange Act applicable to classes of securities, and the indenture provisions of the Trust Indenture Act) to continue to be entered into as they are today until the compliance date for such final rules. Thus, we believe that it is necessary and appropriate in the public interest and consistent with the protection of investors, pending the compliance date for final rules that we may adopt further defining the terms “security-based swap” and “eligible contract participant,” to provide interim exemptions from all provisions of the Securities Act (other than the Section 17(a) antifraud provisions), the registration requirements of the Exchange Act relating to classes of securities, and the indenture provisions of the Trust Indenture Act for those security-based swaps that would have been, prior to the Effective Date, within the definition of “security-based swap agreement” under Securities Act Section 2A<sup>35</sup> and Exchange Act Section 3A<sup>36</sup> and are entered into solely between eligible contract participants (as defined prior to the Effective Date).

## **II. DISCUSSION OF THE INTERIM FINAL RULES**

We are adopting interim final rules to provide certain conditional exemptions under the Securities Act, the Exchange Act and the Trust Indenture Act.

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<sup>35</sup> 15 U.S.C. 77b(b)-1.

<sup>36</sup> 15 U.S.C. 78c-1.

## A. Securities Act Rule 240

We are adopting interim final Securities Act Rule 240 to exempt from all provisions of the Securities Act, except the anti-fraud provisions of Section 17(a), subject to certain conditions, the offer or sale of those security-based swaps that under current law are security-based swap agreements (which under that definition must be entered into between eligible contract participants and subject to individual negotiation) and that will be defined as “securities” under the Securities Act on the Effective Date due solely to the provisions of Title VII. Securities Act Rule 240 will permit the offer or sale of these security-based swaps between eligible contract participants without requiring compliance with Securities Act Section 5.

The definition of “security-based swap” in Title VII and “security-based swap agreement” in Securities Act Section 2A are not identical.<sup>37</sup> In addition, the amendments to the definition of “eligible contract participant” in Title VII narrow in some respects the definition of “eligible contract participant” in the Commodity Exchange Act.<sup>38</sup> In addition, we note that because certain persons may be eligible contract participants today but as a result of the narrower definition may no longer be eligible contract participants after the Effective Date, without an

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<sup>37</sup> See Section 2A of the Securities Act (15 U.S.C. 77b(b)-1).

<sup>38</sup> See Section 1a(12) of the Commodity Exchange Act (7 U.S.C. 1a(12))(prior to July 16, 2011) and Commodity Exchange Act Section 1a(18) (as re-designated and amended by Section 721 of the Dodd-Frank Act. See Pub. L. No. 111-203, § 761(a) (adding Exchange Act Section 3(a)(65), which refers to the definition of eligible contract participant in the CEA). The definition of eligible contract participant contained in the Commodity Exchange Act (as amended by the Dodd-Frank Act) includes: financial institutions; insurance companies; investment companies; other entities and employee benefit plans; State and local municipal entities; market professionals, such as broker dealers, futures commission merchants, floor brokers, and investment advisors; and natural persons with a specified dollar amount invested on a discretionary basis. For purposes of the eligible contract participant definition after the Effective Date, certain of the entities, market professionals, and natural persons must meet certain conditions relating to the amount of assets or amount of monies invested on a discretionary basis. The Dodd-Frank Act amendments to the eligible contract participant definition increased the dollar threshold for certain persons and, with respect to natural persons, replaced a “total assets” test with an “amounts invested on a discretionary basis” test.

exemption, certain counterparties may not be able to offer or sell such security-based swaps without compliance with the registration requirements of the Securities Act.<sup>39</sup> As a result of such differences, to avoid uncertainty as to the applicability of the Securities Act registration requirements pending the compliance date for final rules that we may adopt further defining the terms “security-based swap” and “eligible contract participant” and to allow transactions between persons who are eligible contract participants today, we believe it is appropriate to provide an exemption that will allow market participants to continue to enter into transactions that come within the pre-Dodd-Frank Act definition of “security-based swap agreements.”

Under Securities Act Rule 240, a security-based swap will be exempt from the registration requirements of the Securities Act if it would have been a “security-based swap agreement” under the Securities Act prior to the Effective Date and is entered into between eligible contract participants (as that term was defined prior to the Effective Date).<sup>40</sup> The purpose of these conditions is to allow those types of security-based swaps that were not defined as a “security” under the Securities Act prior to the Effective Date to continue to be transacted following the Effective Date until the compliance date for final rules that we may adopt further defining the terms “security-based swap” and “eligible contract participant.”<sup>41</sup>

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<sup>39</sup> See Pub. L. No. 111-203 § 768(b) (adding Section 5(d) of the Securities Act). Under Section 5(d), no offers or sales of security-based swaps may be made to non-eligible contract participants unless there is an effective registration statement under the Securities Act covering transactions in such security-based swap and any security-based swap transaction with a non-eligible contract participant must be effected on a national securities exchange. In our Effective Date Order, we have provided an exemption, under certain circumstances, to allow transactions to continue with persons who today are eligible contract participants. See Effective Date Order, *supra* note 19.

<sup>40</sup> See 7 U.S.C. 1a(12). As we note above, the exemption applies only to those persons who are within the definition of “eligible contract participant” contained in the definition of “swap agreement” under Securities Act Section 2A. See 15 U.S.C. 77b(b)-1 and Pub. L. No. 106-554, 114 Stat. 2763, 2763A-378 (2001).

<sup>41</sup> We note that the exemption will not cover credit-default swaps that are covered by the Temporary CDS Rules, as such cleared credit default swaps may not come within the definition of “security-

**B. Exchange Act Rule 12a-11 and Rule 12h-1(i)**

We also are adopting two interim final rules relating to Exchange Act registration of security-based swaps. We are adopting interim final Exchange Act Rule 12a-11 to exempt any security-based swap offered and sold in reliance on Securities Act Rule 240 from the provisions of Exchange Act Section 12(a). As with our recent exemption affecting persons who are eligible contract participants, this exemption is intended to allow trading activities relating to those security-based swaps that under current law are security-based swap agreements with eligible contract participants to continue, provided the parties rely on the Rule 240 Securities Act exemption with respect to such security-based swaps. We also are adopting an interim final amendment to Exchange Act Rule 12h-1 to exempt any security-based swap offered and sold in reliance on Securities Act Rule 240 from the provisions of Exchange Act Section 12(g). While we do not know whether there will be a class of security-based swaps that otherwise would satisfy the registration threshold under Exchange Act Section 12(g), we believe it is appropriate to provide this exemption while we continue to learn about and evaluate the type of security-based swap transactions that have been and will be transacted.

**C. Trust Indenture Act Rule 4d-12**

We are adopting an interim final rule under Trust Indenture Act Section 304(d) that will exempt any security-based swap offered or sold in reliance on Securities Act Rule 240 from having to comply with the provisions of the Trust Indenture Act. We believe an exemption from the Trust Indenture Act is appropriate in this situation.

The Trust Indenture Act is aimed at addressing problems that unregulated debt offerings pose for investors and the public, and provides a mechanism for debt holders to protect and

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based swap agreement” because of the absence of the condition that they be subject to individual negotiation.

enforce their rights with respect to the debt. We do not believe that the protections contained in the Trust Indenture Act are needed at this time to protect eligible contract participants to whom a sale of security-based swaps is made in reliance on Securities Act Rule 240. At this point, we believe that the identified problems that the Trust Indenture Act is intended to address do not occur in the offer and sale of these security-based swaps. For example, these security-based swaps are contracts between two parties and, as a result, do not raise the same problem regarding the ability of parties to enforce their rights under the instruments as would, for example, a debt offering to the public. Moreover, enforcement of contractual rights and obligations under these security-based swaps would occur directly between such parties, and it appears that the Trust Indenture Act provisions would not provide any additional meaningful substantive or procedural protections.

Accordingly, due to the nature of those security-based swaps that may be sold in reliance on Securities Act Rule 240, we do not believe the protections contained in the Trust Indenture Act are currently needed with respect to those instruments. Therefore, we believe the exemption is necessary and appropriate in the public interest, consistent with the protection of investors and the purposes fairly intended by the Trust Indenture Act.

#### **D. Request for Comment**

We request and encourage any interested person to submit comments regarding the interim final rules. In particular, we solicit comment on the following questions:

1. How will the exemptions affect, if at all, the manner in which security-based swaps are transacted today and are expected to be transacted following the Effective Date?
2. Will the counterparties to security-based swaps be able to rely on other available exemptions from registration under the Securities Act and the Exchange Act? If not,

why? Is further guidance or rules needed in this regard? If so, what type of guidance or rules would be helpful?

3. Are security-based swaps transacted today or expected to be transacted following the Effective Date in a manner that would not permit the parties to rely on existing exemptions under the Securities Act and the Exchange Act? If so, please explain in detail why existing exemptions would not be available.
4. Should we consider additional exemptions under the Securities Act and the Exchange Act for security-based swaps traded on a national securities exchange or security-based SEF with eligible contract participants? Should an exemption from Exchange Act registration be provided if all holders of the class of security-based swap are eligible contract participants? Why or why not? What conditions to any such exemption would be appropriate, if any?
5. Should we consider providing an exemption under the Securities Act that would allow a public offering of uncleared security-based swaps to eligible contract participants on a registered security-based SEF or national securities exchange? Why or why not? What conditions to any such exemption would be appropriate, if any?
6. We are interested in understanding what type of security-based swaps might not be eligible for the interim final exemptions. Are there security-based swaps transactions today that would not be encompassed within the scope of the interim final exemptions and that should be covered?
7. Do the interim final exemptions apply to all security-based swaps that should be exempted from the Securities Act, the Exchange Act and the Trust Indenture Act as of the



Effective Date? If not, how should the interim final exemptions be revised such that these other security-based swaps would be included within the interim final exemptions?

8. The interim final Securities Act exemption contains particular conditions. Should the Securities Act exemption in Securities Act Rule 240 be conditioned in this manner? If not, why not?
9. Are the exemptions from the Securities Act, the Exchange Act and the Trust Indenture Act appropriate? If not, why not? Should we take a different approach?

### **III. TRANSITION AND EXPIRATION DATE OF INTERIM FINAL RULES**

The interim final rules will remain in effect until the compliance date for final rules that we may adopt further defining the terms “security-based swap” and “eligible contract participants.” We anticipate that this term of the exemptions will provide us with time to evaluate the market for security-based swaps, and consider whether there are other exemptions that we should consider regarding security-based swap transactions between eligible contract participants.

Adoption of the interim final rules, which will be effective on [effective date], will minimize disruptions and costs to the security-based swap markets that could occur on the Effective Date as a result of the effectiveness of the definitions of “security-based swap” and “eligible contract participant” on the Effective Date prior to the completion of rulemakings to further define these terms. We have included several requests for comment in this release. We will consider the public comments we receive in determining whether we should revise the interim final rules in any respect, as well as other actions we should take with respect to such exemptions.

### **IV. OTHER MATTERS**

The Administrative Procedure Act generally requires an agency to publish notice of a proposed rulemaking in the Federal Register.<sup>42</sup> This requirement does not apply, however, if the agency “for good cause finds...that notice and public procedure are impracticable, unnecessary, or contrary to the public interest.”<sup>43</sup> Further, the Administrative Procedure Act also generally requires that an agency publish an adopted rule in the Federal Register 30 days before it becomes effective.<sup>44</sup> This requirement does not apply, however, if the agency finds good cause for making the rule effective sooner.<sup>45</sup> We, for good cause, find that notice and solicitation of comment before adopting the new rules is impracticable, unnecessary, or contrary to the public interest.

For the reasons we discussed throughout this release, we believe that we have good cause to act immediately to adopt the new rules on an interim final basis. The interim final rules are intended to minimize disruptions and costs to the security-based swap markets that could occur on the Effective Date as a result of the effectiveness of the definitions of “security-based swap” and “eligible contract participant” on the Effective Date prior to the completion of rulemakings to further define these terms. In addition, we had previously anticipated that additional exemptions would not be needed to preserve the status quo because we assumed that existing exemptions under the Securities Act would be available to participants in security-based swap transactions after the Effective Date. We have become aware, however, due to comments we have recently received, that there may be questions as to whether such exemptions may be available for all types of trading activities that may occur today involving instruments that will or

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<sup>42</sup> See 5 U.S.C. 553(b).

<sup>43</sup> Id.

<sup>44</sup> See 5 U.S.C. 553(d).

<sup>45</sup> Id.

may be encompassed in the definition of “security-based swap.”<sup>46</sup> Moreover, we have requested comment on trading activities in our recent SBS Exemption Proposing Release.<sup>47</sup> We emphasize that we are requesting comments on the interim final rules and will carefully consider any comments that we receive in determining whether we should revise the interim final rules in any respect, as well as other actions we should take with respect to such exemptions.

The interim final rules will remain in effect until the compliance date for final rules that we may adopt further defining the terms “security-based swap” and “eligible contract participant.” We find that there is good cause to have the new rules effective as interim final rules and that notice and public procedure in advance of effectiveness of the interim final rules is impracticable, unnecessary and contrary to the public interest.<sup>48</sup>

## **V. PAPERWORK REDUCTION ACT**

The interim final rules do not impose any new “collections of information” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”),<sup>49</sup> nor do they create any new filing, reporting, recordkeeping, or disclosure reporting requirements. Accordingly, we are not submitting the interim final rules to the Office of Management and Budget for review in accordance with the PRA.<sup>50</sup> We request comment on whether our conclusion that there are no collections of information is correct.

## **VI. COST-BENEFIT ANALYSIS**

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<sup>46</sup> See Trade Association Letter, *supra* note 22.

<sup>47</sup> See SBS Exemption Proposing Release, *supra* note 27.

<sup>48</sup> This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rule amendment to become effective notwithstanding the requirement of 5 U.S.C. 801 (if a federal agency finds that notice and public comment are “impractical, unnecessary or contrary to the public interest,” a rule “shall take effect at such time as the federal agency promulgating the rule determines”).

<sup>49</sup> 44 U.S.C. 3501 *et seq.*

<sup>50</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

We are adopting interim final rules that will provide exemptions for those security-based swaps that under current law are "security-based swap agreements" between "eligible contract participants" (each as defined today) and that will be defined as "securities" under the Securities Act and the Exchange Act as of the Effective Date due solely to the provisions of Title VII. The interim final rules will exempt these security-based swaps from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provisions, as well as exempt these security-based swaps from Exchange Act registration requirements and from the provisions of the Trust Indenture Act, provided certain conditions are met.

**A. Benefits**

The interim final rules are intended to minimize disruptions and costs to the security-based swap markets that could occur on the Effective Date until the compliance date for final rules that we may adopt further defining the terms "security-based swap" and "eligible contract participant". The purpose of the exemptions is to allow market participants to continue to enter into those security-based swaps that under current law are defined as security-based swap agreements as they do today without concern that such security-based swap transactions may not comply with the provisions of the Securities Act, the registration provisions of the Exchange Act applicable to a class of security-based swaps, or the indenture provisions of the Trust Indenture Act. The exemptions will minimize the uncertainty as to the applicability of the Securities Act, the Exchange Act and the Trust Indenture Act that could occur on the Effective Date with respect to those security-based swaps that under current law are defined as security-based swap agreements as a result of the effectiveness of the definitions of "security-based swap" and "eligible contract participant" on the Effective Date prior to the completion of rulemakings to further define these terms.

Absent the exemptions, following the Effective Date, the offer and sale of those security-based swaps that under current law are defined as security-based swap agreements may have to be registered under the Securities Act, certain of those security-based swaps may have to be registered as a class under the Exchange Act, and the provisions of the Trust Indenture Act may need to be complied with. We believe that requiring compliance with these provisions likely would disrupt and impose unnecessary costs on this segment of the security-based swap markets. Absent the exemptions, we believe that certain market participants would incur additional costs due to compliance with the registration requirements of the Securities Act and the Exchange Act, as well as compliance with the provisions of the Trust Indenture Act. It also is possible that without the exemptions, a market participant may not continue to participate in these types of transactions if compliance with these provisions were infeasible (economically or otherwise).

A market participant will benefit from the exemptions because it will not have to file a registration statement covering the offer and sale of these security-based swaps or evaluate the availability of another existing exemption from such registration requirements. If the market participant is not required to register the offer and sale of these security-based swaps, it will not have to incur the additional costs of such registration, including legal and accounting costs. The availability of the exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act also would mean that market participants would not incur the costs of preparing disclosure documents describing these security-based swaps and from preparing indentures and arranging for the services of a trustee.

## **B. Costs**

The interim final rules are exemptions, and thus do not impose new requirements on market participants. We recognize that a consequence of the exemptions would be the

unavailability of certain remedies under the Securities Act and the Exchange Act and certain protections under the Trust Indenture Act for an interim period to the extent that any of these security-based swap transactions otherwise would be subject to the registration requirements of the Securities Act and the Exchange Act. Absent the exemptions, a market participant may have to file a registration statement covering the offer and sale of the security-based swaps, may have to register the class of security-based swaps that it has issued under the Exchange Act, which would provide investors with civil remedies in addition to antifraud remedies, and may have to satisfy the applicable provisions of the Trust Indenture Act. A registration statement covering the offer and sale of security-based swaps may provide certain information about the market participants, the security-based swap contract terms, and the identification of the particular reference securities, issuers, or loans underlying the security-based swap. As a result of the interim final rules, while an investor would be able to pursue an antifraud action in connection with the purchase and sale of security-based swaps under Exchange Act Section 10(b), it would not be able to pursue civil remedies under Securities Act Sections 11 or 12. We could still pursue an antifraud action in the offer and sale of security-based swaps under Securities Act Section 17(a).

## **VII. CONSIDERATION OF IMPACT ON THE ECONOMY, BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION**

Exchange Act Section 23(a)(2)<sup>51</sup> requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, Securities Act

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<sup>51</sup> 15 U.S.C. 78w(a)(2).

Section 2(b)<sup>52</sup> and Exchange Act Section 3(f)<sup>53</sup> require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

We are adopting interim final rules that would provide exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act for those security-based swaps that under current law are security-based swap agreements and will be defined as “securities” under the Securities Act and the Exchange Act as of the Effective Date due solely to the provisions of Title VII. Because these exemptions would maintain the status quo with respect to the ability of market participants to engage in transactions in these security-based swaps, we do not believe that our actions today will impose a burden on competition. We also believe that the interim final rules will promote efficiency by minimizing disruptions and costs to the security-based swap markets that could occur as a result of the effectiveness of the definitions of “security-based swap” and “eligible contract participant” on the Effective Date prior to the completion of rulemakings to further define these terms. By allowing transactions in security-based swaps that under current law are security-based swap agreements to continue to be entered into between eligible contract participants as they are today until the compliance date for final rules that we may adopt further defining the terms “security-based swap” and “eligible contract participant,” and to the extent that such security-based swaps are used to hedge risks, including those related to the issuance of the referenced securities (as occurs with equity swaps and the issuance of convertible bonds, for example), the interim final rules will prevent potential impairment of the capital formation process.

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<sup>52</sup> 15 U.S.C. 77b(b).

<sup>53</sup> 15 U.S.C. 78c(f).

The Commission requests comment on all aspects of this analysis and, in particular, on whether the interim final rules will place a burden on competition, as well as the effect of the proposal on efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views, if possible.

### **VIII. REGULATORY FLEXIBILITY ACT CERTIFICATION**

The Commission hereby certifies that pursuant to 5 U.S.C. 605(b) that the interim final rules contained in this release will not have a significant economic impact on a substantial number of small entities.<sup>54</sup> The interim final rules apply only to counterparties that may engage in security-based swap transactions in reliance on the interim final rule providing an exemption under the Securities Act. The interim final exemption under the Securities Act provides that the exemption is available only to security-based swaps that are entered into between eligible contract participants, as that term is defined in Section 1a(12) of the Commodity Exchange Act prior to the Effective Date, and other than with respect to persons determined by the CFTC to be eligible contract participants pursuant to Section 1a(12)(C) of the Commodity Exchange Act (7 U.S.C. 1a(12)). Based on our existing information about the participants in the security-based swap markets, the Commission believes that the interim final rules would apply to few, if any, small entities.<sup>55</sup> For this reason, the interim final rules should not have a significant economic impact on a substantial number of small entities. We encourage written comments regarding this certification.

### **IX. STATUTORY AUTHORITY AND TEXT OF THE RULES AND AMENDMENTS**

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<sup>54</sup> See Securities Act Rule 157 (17 CFR 230.157), Exchange Act Rule 0-10(a) (17 CFR 240.0-10(a)) and Trust Indenture Act Rule 0-7 (17 CFR 260.0-7).

<sup>55</sup> For example, as revealed in a current survey conducted by Office of the Comptroller of the Currency, 99.9% of credit default swap positions by U.S. Commercial Banks and Trusts are held by those with assets over \$10 billion. See Office of the Comptroller of the Currency, “Quarterly Report on Bank Trading and Derivatives Activities First Quarter 2011” (2011).



The rules described in this release are being adopted under the authority set forth in Sections 19 and 28 of the Securities Act; Sections 12(h), 23(a) and 36 of the Exchange Act; and Section 304(d) of the Trust Indenture Act.

**List of Subjects in 17 CFR Parts 230, 240 and 260**

Reporting and recordkeeping requirements, Securities.

**TEXT OF THE RULES AND AMENDMENTS**

For the reasons set out in the preamble, the Commission amends Title 17, Chapter II, of the Code of Federal Regulations as follows:

**PART 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933**

1. The authority citation for Part 230 continues to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

\* \* \* \* \*

2. Section 230.240 is added to read as follows:

**§230.240 Exemption for certain security-based swaps.**

(a) Except as expressly provided in paragraph (b) of this section, the Act does not apply to the offer or sale of any security-based swap that is:

(1) A *security-based swap agreement*, as defined in Section 2A of the Act (15 U.S.C. 77b(b)-1) as in effect prior to July 16, 2011; and

(2) Entered into between eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act (7 U.S.C. 1a(12)) as in effect prior to July 16, 2011, other than

a person who is an eligible contract participant under Section 1a(12)(C) of the Commodity Exchange Act as in effect prior to July 16, 2011).

(b) The exemption provided in paragraph (a) of this section does not apply to the provisions of Section 17(a) of the Act (15 U.S.C. 77q(a)).

(c) This rule will expire on the compliance date for final rules that the Commission may adopt further defining both the terms *security-based swap* and *eligible contract participant*. In such event, the Commission will publish a rule removing this section from 17 CFR part 230 or modifying it as appropriate.

**PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE  
ACT OF 1934**

3. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq., 18 U.S.C. 1350, and 12 U.S.C. 5221(e)(3), unless otherwise noted.

\* \* \* \* \*

4. Section 240.12a-11 is added to read as follows:

**§ 240.12a-11 Exemption of security-based swaps sold in reliance on Securities Act of 1933  
Rule 240 (§230.240) from section 12(a) of the Act.**

(a) The provisions of Section 12(a) of the Act (15 U.S.C. 78l(a)) do not apply to any security-based swap offered and sold in reliance on Rule 240 under the Securities Act of 1933.

(b) This rule will expire on the compliance date for final rules that the Commission may adopt further defining both the terms *security-based swap* and *eligible contract participant*.

In such event, the Commission will publish a rule removing this section from 17 CFR part 240 or modifying it as appropriate.

5. Section 240.12h-1 is amended by adding paragraph (i) to read as follows:

**§ 240.12h-1 Exemptions from registration under section 12(g) of the Act.**

\* \* \* \* \*

(i) Any security-based swap offered and sold in reliance on Rule 240 under the Securities Act of 1933. This rule will expire on the compliance date for final rules that the Commission may adopt further defining both the terms *security-based swap* and *eligible contract participant*. In such event, the Commission will publish a rule removing this paragraph (i) from 17 CFR part 240 or modifying it as appropriate.

**PART 260 – GENERAL RULES AND REGULATIONS, TRUST INDENTURE ACT OF 1939**

6. The authority citation for Part 260 continues to read as follows:

Authority: 15 U.S.C. 77eee, 77ggg, 77nnn, 77sss, 78ll(d), 80b-3, 80b-4, and 80b-11.

7. Section 260.4d-12 is added to read as follows:

**§ 260.4d-12 Exemption for security-based swaps offered and sold in reliance on Securities Act of 1933 Rule 240 (§230.240).**

Any security-based swap offered and sold in reliance on Rule 240 of this chapter (17 CFR 230.240), whether or not issued under an indenture, is exempt from the Act. This rule will expire on the compliance date for final rules that the Commission may adopt further defining both the terms *security-based swap* and *eligible contract participant*. In such event, the

Commission will publish a rule removing this section from 17 CFR part 260 or modifying it as appropriate.

By the Commission.

Elizabeth M. Murphy  
Secretary

Date: July 1, 2011