CLEARY GOTTLIEB

Alert Memo

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SEC Proposes Business Conduct Standards

On June 29, 2011, the U.S. Securities and Exchange Commission (the "**SEC**") issued proposed rules (the "**SEC Business Conduct Proposal**")[1] to implement provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("**Dodd-Frank**") related to certain business conduct standards for security-based swap dealers ("**SBSDs**") and major security-based swap participants ("**MSBSPs**," and, together with SBSDs, "**SBS Entities**"). The SEC Business Conduct Proposal implements statutory provisions substantially identical to those addressed by the U.S. Commodity Futures Trading Commission (the "**CFTC**," and, together with the SEC, the "**Commissions**") in its December 2010 proposal for external business conduct standards (the "**CFTC Business Conduct Proposal**")[2] for swap dealers ("**SDs**") and major swap participants ("**MSPs**," and, together with SDs, "**Swap Entities**") and related rulemakings under Dodd-Frank.[3] Comments on the SEC Business Conduct Proposal are due by August 29, 2011.

The SEC Business Conduct Proposal would avoid most of the adverse potentially significant consequences of the CFTC Business Conduct Proposal. In this regard, it is clear that the SEC Business Conduct Proposal benefitted significantly from the six-month public comment process following the release of the CFTC Business Conduct Proposal. As a result, however, despite Dodd-Frank's mandate for agency coordination and consistency, the SEC and CFTC's proposals vary significantly, potentially subjecting market participants to very different rules for similar products traded in the same market, such as broad-based index and single-name credit default swaps and total rate of return swaps. Key examples of differences between the proposals include:

- ***Advisors to Special Entities***. While both the CFTC Business Conduct Proposal and the SEC Business Conduct Proposal provide that an SD or SBSD would be deemed an advisor if it makes a recommendation to a Special Entity, the SEC Business Conduct Proposal would also include a safe harbor. An SBSD would not be deemed an advisor

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1 SEC Proposed Rule, Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, dated June 29, 2011 (publication in Federal Register forthcoming).

2 CFTC Proposed Rule, Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 75 Fed Reg. 80638 (Dec. 22, 2010); see also CGSH Alert Memo: CFTC's Proposed Business Conduct Regulation: Can the OTC Swap Market Survive the "Cure"? (Jan. 7, 2011).

3 CFTC Proposed Rules, Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71397 (Nov. 23, 2010); Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71391 (Nov. 23, 2010); and Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant, 75 Fed. Reg. 70881 (Nov. 19, 2010).

under the safe harbor if (1) the Special Entity represents in writing that it will not rely on recommendations provided by the SBSD and will instead rely on advice from a qualified independent representative; (2) the SBSD has a reasonable basis to believe that the Special Entity is advised by a qualified independent representative; and (3) the SBSD discloses to the Special Entity that it is not undertaking to act in the best interests of the Special Entity. To the extent an SBSD avoids being deemed to be acting as an advisor to a Special Entity, it also avoids the special duties required of such an advisor, compliance with which might then trigger fiduciary status under ERISA. The SEC notes, however, that an SBS Entity must separately consider whether it is subject to registration under the Investment Advisers Act of 1940 (the "**Advisers Act**") as a result of its activities in security-based swaps ("**SBS**").

- ***Reliance on Written Representations***. Many of the proposed business conduct requirements – including know your counterparty, verification of counterparty eligibility, institutional suitability, and requirements relating to pension plans, municipalities and other Special Entities[4] – require a Swap or SBS Entity to verify certain information about its counterparty. The CFTC Business Conduct Proposal would require a Swap Entity to have a "reasonable basis" to believe that its counterparty's sufficiently detailed representations are reliable; thus, imposing an affirmative diligence requirement for satisfaction of these obligations. The SEC Business Conduct Proposal, in contrast, proposes two alternative standards and requests comment on which alternative to adopt. Under the first standard, an SBS Entity could rely on a representation unless it knows that the representation is not accurate (*i.e.*, a subjective standard). Under the second standard, an SBS Entity would need to make further inquiry to verify the accuracy of a representation if the SBS Entity has information that would cause a reasonable person to question its accuracy (*i.e.*, an objective standard).[5]

- ***Counterparties to Special Entities***. Dodd-Frank requires that a Swap or SBS Entity counterparty to a Special Entity have a reasonable basis to believe that the Special Entity has a qualified independent representative. The SEC Business Conduct Proposal would include a safe harbor to the independence test. The representative would be deemed to be independent of the SBS Entity under the safe harbor if, within the past year, the representative (1) is not and was not an associated person (such as an affiliate) of the SBS Entity and (2) has not received more than ten percent of its gross revenues directly or indirectly from the SBS Entity or its affiliates. In contrast, the CFTC Business Conduct Proposal included a new, three-prong independence test that

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[4] Under Dodd-Frank, "Special Entity" includes (1) a Federal agency; (2) a State, State agency, city, county, municipality or other political subdivision of a State; (3) any employee benefit plan, as defined in Section 3 of the Employee Retirement Income Security Act of 1974 ("**ERISA**"); (4) any governmental plan, as defined in Section 3 of ERISA; and (5) any endowment, including an endowment that is an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986.

[5] The SEC does not clarify whether information known to individuals other than those with knowledge of the relevant SBS transaction would be disregarded for these purposes.

would require, for example, a determination as to whether or not a "material business relationship" exists between the representative and the Swap Entity.

- ***Duties of Swap/SBS Entities***. Dodd-Frank requires Swap and SBS Entities to comply with a number of duties concerning risk management, regulatory disclosures and data retention, mitigation of conflicts of interest and antitrust violations. The CFTC's approach in this area has been to propose detailed rules prescribing the specific elements of Swap Entity policies implementing these duties. In contrast, the SEC proposes to require SBS Entities to adopt written policies and procedures reasonably designed to ensure compliance with the statutory duties, without any specific prohibitions or additional requirements. Because of this, the SEC's approach would afford SBS Entities greater flexibility in establishing appropriate policies for compliance, taking into account the SBS Entities' unique characteristics, management structure and needs.

- ***Requirements Not Mandated by Dodd-Frank***. Several new requirements proposed in the CFTC Business Conduct Proposal were not mandated by Dodd-Frank, and in many cases the SEC has chosen not to propose parallel requirements for SBS Entities. The SEC Business Conduct Proposal thus does not propose new requirements regarding confidential counterparty information and front running prohibitions of the type proposed by the CFTC. Instead, the SEC has opted to rely on existing anti-fraud prohibitions and requirements for policies and procedures reasonably designed to mitigate conflicts of interest. Both Commissions have, however, proposed know your counterparty, valuation disclosure, clearing disclosure, institutional suitability and pay-to-play requirements, none of which were mandated by Dodd-Frank.

Nevertheless, the SEC Business Conduct Proposal would, if adopted, pose several, in some cases potentially significant, practical difficulties:

- ***Electronically Executed Security-Based Swaps.*** The SEC's proposed exception for electronically executed SBS would only apply to transactions to the extent they are (1) executed on a registered SBS execution facility ("**SBSEF**") or national securities exchange ("**NSE**"); and (2) the SBS Entity does not know the identity of the counterparty, at any time up to and including execution of the transaction. The limited scope of this exception would, if adopted, be problematic for transactions executed on single dealer screens or other non-SBSEF forms of electronic execution, as well as transactions executed using request-for-quote or other similar forms of execution where the counterparty's identity is known before execution, but the time between disclosure of counterparty identity and execution is too limited a timeframe within which to perform transaction specific pre-execution obligations.

- ***Mid-Market Value.*** The SEC has proposed a requirement to provide a mid-market value or model-based valuation for uncleared SBS, similar to a requirement in the CFTC Business Conduct Proposal, which, like the CFTC proposal, would raise concerns in the case of transactions with ERISA plans to the extent such valuations could be considered "advice" under proposed Department of Labor ("**DOL**")

regulations. This could cause the SBS Entity providing the valuation to be deemed an ERISA fiduciary and the SBS to become prohibited under ERISA.

- ***Definition of Special Entity.*** Like the CFTC Business Conduct Proposal, the SEC Business Conduct Proposal does not clarify the scope of the "Special Entity" definition, including its potential application to plan asset funds, foreign pension plans and organizations that use endowments funds as a source of payment or collateral.

- ***Disclosure of Capacity.*** The SEC proposes to require that, if an SBSD engages in business, or has engaged in business within the last 12 months, with its counterparty in more than one capacity, it must disclose the material differences between such capacities in connection with the SBS *and any other financial transaction or service involving the counterparty.* It will likely prove impractical for SBSDs to ascertain and disclose every actual specific financial relationship between the SBSD and its counterparties depending on the range of business conducted in the SBSD entity.

- ***Chief Compliance Officers.*** The SEC proposes to require that the compensation and removal of an SBS Entity's chief compliance officer ("**CCO**") be approved by a majority of the SBS Entity's board of directors. This requirement is not mandated by Dodd-Frank and stands in contrast to requirements applicable to other more senior executives for whom such approval is not required. It is not clear whether this proposal adds meaningfully to existing guidelines issued by all of the prudential regulators, including the SEC.[6]

A more detailed comparison of the CFTC and SEC Business Conduct Proposals is included in the attached **Appendix**.

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[6] See SEC Proposed Rule, Incentive-Based Compensation Arrangements, 76 Fed. Reg. 21170 (April 14, 2011) (proposing compensation rules for risk management personnel, jointly with the other six prudential regulators).

Appendix – Comparison of the CFTC and SEC Business Conduct Proposals

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Scope and Definitions (23.400 and 401) / (15Fh-1 and 2)	The proposal would apply in connection with swap transactions and in connection with swaps that are offered but not entered into. The definitions for SD and MSP cover persons acting on behalf of SDs and MSPs, respectively, including their associated persons. "Associated person" is defined to include partners, officers, employees and other agents associated with an SD or MSP in any capacity that involves the solicitation or acceptance of swaps or the supervision of any person or persons so engaged, except for persons whose functions are solely clerical or ministerial.	The proposal would apply in connection with entering into SBS and, as relevant, over the term of the SBS. The proposal, however, would not apply to SBS executed prior to the compliance date of the final rules. The definitions of SBSD and MSBSP include, "where relevant," an associated person of the SBSD or MSBSP. "Associated person" is defined to include (i) any partner, officer, director or branch manager, (ii) any person directly or indirectly controlling, controlled by or under common control with the SBSD or MSBSP and (iii) any employee of the SBSD or MSPSP, in each case subject to an exception for persons whose functions are solely clerical or ministerial.	The CFTC proposal would generally apply to swaps that are offered but not entered into; the SEC proposal would not apply to offered swaps except under the independent representative requirement for Special Entities and the pay to play rule (both discussed below). The CFTC does not clarify whether the proposal would apply to outstanding swaps executed prior to the effective date of the final rules. Under the SEC proposal, "associated persons" of SBS Entities would be subject to the business conduct standards "where relevant," but the SEC does not specify which circumstances would render such associated persons relevant.
Private Right of Action/Right of Rescission	The CFTC does not address whether violations of the business conduct standards would give rise to private rights of action or rights of rescission. Section 22(a)(1)(B) of the Commodity Exchange Act ("**CEA**"), taken together with Section 4s(h)(1), provides a private right of action for violations of the CEA. Additionally, the CEA does not contain any express limitations on rescission for such violations (contra violations of Section 2(h)'s clearing requirement).	The SEC states in the preamble that "Section 15F(h) of the Exchange Act does not, by its terms, create a new private right of action or right of rescission, nor do we anticipate that the proposal would create any new private right of action or right of rescission."	Whether the CFTC's business conduct standards would give rise to such remedies has been a major concern, particularly for requirements that contain vague standards more typical in self-regulatory organization ("**SRO**") rules.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Reliance on Counterparty Representations Generally (23.401(e)) / (no SEC proposed)	A Swap Entity that seeks to rely on the written representations of a counterparty to satisfy any requirement under the proposed business conduct standards would be required to have a "reasonable basis" to believe that the sufficiently detailed representations are reliable. The CFTC proposal would place an affirmative obligation on Swap Entities to investigate representations proactively and would require lengthy and detailed representations, e.g., to determine that a Special Entity's chosen independent representative is sufficiently qualified.	Two standards for reliance on representations are proposed. Under the first standard, an SBS Entity could rely on a representation unless it knows that the representation is not accurate. Under the second standard, an SBS Entity would need to make further reasonable inquiry to verify the accuracy of a representation if the SBS Entity has information that would cause a reasonable person to question its accuracy. Representations may not simply identify the relevant statutory or rule provision in a conclusory fashion (e.g., a counterparty must represent that it has $10 million in assets, not that it is an "eligible contract participant," and a counterparty must state that it is not one of the types of entities included in the definition of Special Entity, not merely that it is not a Special Entity).	The SEC is considering adopting either of the standards across the board or adopting different standards for different requirements. The first proposed standard is entirely subjective, in that it depends solely on the SBS Entity's own evaluation of information it has. The second standard includes an objective element, in that it also depends on what a reasonable person would conclude if such person had in his or her possession the same information as the SBS Entity. Neither standard specifies whether the individuals specifically involved in execution of the SBS must have knowledge of the information in question. Absent a red flag, the SEC's proposal would not require costly, time-consuming, and intrusive diligence/inquiries on the part of the SBS Entity.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Know Your Counterparty (23.402(c)) / (15Fh-3(e))	Would require a Swap Entity to use reasonable due diligence to know and retain a record of the essential facts concerning a counterparty, including facts necessary to (i) comply with applicable laws, regulations and rules, (ii) effectively service the counterparty, (iii) implement any special instructions from the counterparty and (iv) evaluate the previous swaps experience, financial wherewithal and flexibility, trading objectives and purposes of the counterparty.	Would require an SBSD to have policies and procedures reasonably designed to obtain and retain a record of the essential facts concerning a known counterparty that are necessary to (i) comply with applicable laws, regulations and rules, and (ii) effectuate the SBSD's credit and operational risk management policies in connection with transactions entered into with such counterparty.[1] Additionally, "essential facts" include (i) information regarding the authority of any person acting for such counterparty, and (ii) if the counterparty is a Special Entity, such background information regarding the independent representative as the SBSD reasonably deems appropriate.	The SEC proposal is implemented through a "policies and procedures" requirement; the CFTC proposal would, by its terms, require affirmative due diligence. The SEC proposal specifically states that the requirement only applies to counterparties *known* to the SBSD. The SEC proposal does not apply to MSBSPs. The CFTC's "essential facts" are far more subjective and would require intrusive inquiries about the counterparty's business, e.g., its "previous swaps experience, financial wherewithal and flexibility, trading objectives and purposes"; the SEC proposal calls for objective information that can be more easily obtained through simple representations. The CFTC proposal may make a Swap Entity a *de facto* advisor by requiring, among other things, facts necessary to "effectively service the counterparty," "evaluate previous swaps experience" and "implement any special instructions from the counterparty."

[1] The SEC plans to address an SBSD's operational and credit risk management practices in a separate rulemaking.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Anti-Fraud (23.410(a)) / (15Fh-4(a))	Would expand the CEA's special anti-fraud provision for Swap Entities acting as advisors (Section 4s(h)(4)), as amended by Dodd-Frank) to cover non-advisory activity by a Swap Entity.	Would adopt verbatim the Exchange Act's special anti-fraud provision for SBS Entities acting as advisors to Special Entities (Section 15F(h)(4)(A)) but it appears from the preamble that the anti-fraud provision would apply to all SBS Entities regardless of whether they are advisors to Special Entities.	The CFTC states in the preamble that it does not believe scienter should be required to establish liability under the provision; the SEC does not provide guidance on the requisite standard for establishing liability.
Confidential Treatment of Counterparty Information (23.410(b)) / (no SEC rule)	Would prohibit a Swap Entity from disclosing any material confidential information obtained from a counterparty unless (i) such disclosure is necessary for the effective execution of any swap or to hedge any exposure created by such swap and the counterparty specifically consents to such disclosure; or (ii) the CFTC, Department of Justice, or an applicable prudential regulator requests such information.	No similar requirement.	The SEC leaves counterparties free to negotiate the treatment of transactional information, subject to the SBS Entity's conflicts of interest policies. The CFTC proposal prohibits disclosure, in certain circumstances, even with counterparty consent. The CFTC proposal would elevate contractual terms to requirements of federal law and includes inadequate exceptions.
Trading Ahead and Front Running (23.410(c)) / (no SEC rule)	Would make it unlawful for any Swap Entity to enter "knowingly" and without "specific" counterparty consent into a "transaction" for its own benefit ahead of (i) any executable order for a swap received from a counterparty or (ii) any swap that is the subject of a negotiation with a counterparty.	No similar requirement.	The CFTC inappropriately bases its proposal on prohibitions applicable in agency contexts, e.g., for introducing brokers and futures commission merchants. The CFTC proposal has no exceptions for (i) hedging, (ii) accommodation of customer orders, (iii) model-driven trades, (iv) or trades which have no impact on the counterparty. Presumably, trades conducted on the other side of an information barrier would not violate the "knowingly" requirement under the CFTC proposal.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Verification of Counterparty Status – Eligible Contract Participant ("ECP") (23.430(a)) / (15Fh-3(a)(1))	Would require a Swap Entity to verify that a counterparty is an ECP prior to offering or entering into a swap, unless the transaction is executed on a swap execution facility ("**SEF**") or designated contract market ("**DCM**") and the Swap Entity does not know the identity of the counterparty.	Would require an SBS Entity to verify that a counterparty whose identity is known to an SBS Entity prior to execution is an ECP before entering into an SBS other than on a registered NSE or on an SBSEF.	The SEC would permit reliance on representations but would not permit conclusory representations stating simply that the counterparty is an ECP, because such a representation would not demonstrate that the counterparty is aware of the ECP criteria (see section on representations above). The SEC would permit representations in master agreements that can be relied on for subsequent SBS with that counterparty and would not require ongoing verification throughout the life of the SBS; the CFTC seeks comment on whether it should require ongoing verification. The SEC requests comment regarding transactions where the counterparty's identity is only known immediately prior to execution. The CFTC proposal would require verification of ECP status prior to "offering a swap" in addition to entering into a swap.
Verification of Counterparty Status –Special Entity (23.430(b)) / (15Fh-3(a)(2))	Would require a Swap Entity to determine whether a counterparty is a Special Entity prior to offering or entering into a swap.	Would require an SBS Entity to verify whether a counterparty (whose identity is known to the SBS Entity) is a Special Entity prior to executing an SBS transaction with such counterparty.	The SEC would permit reliance on representations but would not permit conclusory representations stating simply that the counterparty is not a Special Entity; instead, the counterparty must state that it is not one of the types of entities included in the definition of Special Entity, as this demonstrates that the counterparty is aware of the Special Entity definition (see section on representations above).

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
			The SEC proposal would not apply in circumstances where the identity of the counterparty is unknown prior to execution;[2] the CFTC proposal would not apply when the swap is both (i) SEF-executed and (ii) the identity of counterparty is unknown. The CFTC proposal would require verification of Special Entity status prior to "offering a swap" in addition to entering into a swap.
Fair and Balanced Communications (23.433) / (15Fh-3(g))	Would require that communications (i) provide a sound basis for evaluating the facts with respect to any swap, (ii) do not make unwarranted claims, and (iii) are balanced (i.e., express the risks to the same extent as the benefits).	Would require that communications (i) provide a sound basis for evaluating the facts with respect to any SBS, (ii) do not make unwarranted claims, and (iii) are balanced (i.e., express the risks to the same extent as the benefits).	The text of the CFTC proposal merely requires fair and balanced communications but in the preamble the CFTC defines "fair and balanced" as the SEC does in the text of its proposal.

[2] The SEC would not require verification of ECP status for exchange-executed SBS because, under a separate proposed rule, SBSEFs would be prohibited from providing access to non-ECPs. However, an SBS Entity would be required to verify Special Entity status even for exchange-executed SBS, assuming the identity of the counterparty is known (this differs from the CFTC rule which would apply the same standard for verification of ECP and Special Entity status). See SEC Proposed Rule, Registration and Regulation of Security-Based Swap Execution Facilities, 76 Fed. Reg. 10948 (Feb. 28, 2011).

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Execution Standards for Exchange Traded Swaps/SBS (155.7) / (FINRA Rule 2320)	Would require SDs and other CFTC registrants to execute a swap, if available for trading on a DCM or SEF, on terms that have a "reasonable relationship" to the best terms available. To satisfy this "reasonable relationship" test, a registrant would have a duty to exercise reasonable diligence to ascertain which DCM or SEF offers the best terms available for the transaction, including even those markets in which the registrant does not have trading privileges.	The SEC did not propose a best execution rule for exchange-traded SBS. However, FINRA Rule 2320 requires registered broker-dealers to use reasonable diligence to ascertain the best market for the subject security (e.g., an exchange-traded SBS) and buy or sell in such market that provides as favorable a price as possible under prevailing market conditions.	Unlike the CFTC proposal, FINRA Rule 2320 is not generally applicable on a trade-by-trade basis, but rather requires a regular and rigorous review of transactions and market centers over a period of time. It is also generally applicable in the agency, rather than principal, execution context. In interpreting these requirements, it will be critical for the Commissions and/or FINRA to clarify the factors that may be taken into account by the registrant, including non-price factors such as a registrant's appetite for assuming the relevant risk to the counterparty, the relative profitability of other alternatives for the utilization of its credit capacity with the counterparty, its exposure to the underlier in its portfolio, and risk management considerations.
Disclosures			
Timing and Manner of Disclosures (23.402(f)-(g)) / (15Fh-3(b))	Would require disclosure reasonably prior to execution in a manner reasonably designed to allow the counterparty to assess the disclosures. Would permit any means of disclosure that the parties have agreed to in writing.	Would require disclosure prior to execution in a manner reasonably designed to allow the counterparty to assess the information provided. Would permit any reasonable means of disclosure, provided that a record of any unwritten required disclosure is provided no later than delivery of the trade acknowledgment.	The CFTC would not require disclosures if the swap is SEF-executed and the identity of the counterparty is unknown; the SEC seeks comment on disclosures when the SBS is SBSEF/NSE-executed or when the identity of the counterparty is known only immediately prior or after execution.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
			The SEC believes highly standardized forms of disclosure are consistent with its proposal but anticipates that even such forms of disclosures will require certain provisions to be tailored to the particular transaction, most notably pricing and other transaction-specific commercial terms; the CFTC believes standardized disclosures will often be inadequate, especially for bespoke transactions.
Material Risks and Characteristics (23.431(a)(1)) / (15Fh-3(b)(1))	Would require disclosure to a non-Swap/SBS Entity counterparty of the (i) material risks of the particular swap, which may include market, credit, liquidity, foreign currency, legal, operational and any other applicable risks, and (ii) the material characteristics, including the material economic terms of the swap, the terms relating to the operation of the swap, and the rights and obligations of the parties during the term of the swap.	Would require disclosure to a non-Swap/SBS Entity counterparty of the material risks and characteristics of the particular SBS, including, but not limited to, (i) the material factors that influence the day-to-day changes in valuation, (ii) the factors or events that might lead to significant losses, (iii) the sensitivities of the SBS to those factors and conditions, and (iv) the approximate magnitude of the gains or losses the SBS will experience under specified circumstances.	The SEC, unlike the CFTC, makes clear these disclosures should be tailored to the unique risks and characteristics of the particular SBS product (including risks associated with uncleared SBS) but <u>not</u> tailored to the characteristics of the particular counterparty. The CFTC proposal would seemingly require disclosure of any extrinsic factors that could conceivably materially affect the performance of a swap; the SEC makes clear that it intends to "require disclosure about the material risks and characteristics of the SBS itself and not of the underlying reference security or index."

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
			The SEC, unlike the CFTC, specifically seeks comment on whether the requirements for disclosure of material characteristics of an SBS should be deemed satisfied if the SBS Entity has entered into a master agreement and provided a trade acknowledgement (or draft trade acknowledgement) or other documentation governing the particular SBS to the counterparty.
Scenario Analysis (23.431(a)(1)(i)-(iii)) / (no SEC rule)	Would require a Swap Entity, in the case of a bilateral swap that is not available for trading on a DCM or SEF, to (i) notify its non-Swap Entity counterparty that it may request scenario analysis and (ii) provide such scenario analysis upon request. For so-called "high risk complex bilateral swaps" scenario analysis would be required even without counterparty request.	While scenario analysis is not required under the SEC proposal, the SEC states that scenario analysis can be an appropriate means of disclosing the risks and characteristics of an SBS.	The scope of the CFTC's proposed scenario analysis requirement could be read to go beyond stressing the levels of the underlying market factors and to require more complex and subjective judgments about probable or possible future market states and their relevance to a particular transaction. Providing such analysis under the CFTC proposal could make the Swap Entity a fiduciary under ERISA or an advisor to a Special Entity. Definition of "high risk complex bilateral swap" is subjective and a Swap Entity could be at risk if it failed to provide scenario analysis in circumstances where its own rule-compliant policies and procedures fail to identify a swap as such.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Material Incentives and Conflicts of Interest (23.431(a)(3)) / (15Fh-3(b)(2))	Would require a Swap Entity to provide a non-Swap/SBS Entity counterparty with disclosure reasonably designed to allow the counterparty to assess the Swap Entity's conflicts and incentives, including (i) with respect to disclosure of the price of a swap, the price of the swap and the mid-market value of the swap and (ii) any compensation or other incentives from any source other than the counterparty that the Swap Entity may receive in connection with the swap.	Would require an SBS Entity to disclose to a non-Swap/SBS Entity counterparty any material incentives or conflicts of interest it may have in connection with the SBS, including any compensation or other incentives from any source other than the counterparty in connection with the SBS to be entered into with the counterparty.	The CFTC's required disclosure of the mid-market value could be construed to require the Swap Entity to provide advice. The SEC, unlike the CFTC, makes clear that "incentive" does not refer to expected profits from the SBS itself, but rather to arrangements pursuant to which an SBS Entity may have an incentive to encourage the counterparty to enter into the transaction. The CFTC states that a Swap Entity "would be expected to disclose whether their compensation related to the recommended swap transaction would be greater than for another instrument with similar economic terms offered by the swap dealer or major swap participant"; the SEC does not appear to share this view.
Daily Mark (23.431(c)(1)-(3)) / (15Fh-3(c)(1))	For swaps cleared on a derivatives clearing organization ("**DCO**"), a Swap Entity would be required to notify the counterparty of its right to receive a daily mark from the DCO. For uncleared swaps, a Swap Entity would be required to provide the counterparty with a daily mark, which would be the mid-market value of the swap, as well as the methodology and assumptions used to prepare the daily mark.	For cleared SBS, an SBS Entity would be required to provide the counterparty, upon request, with the end-of-day settlement price the SBS Entity receives from the clearing agency. For uncleared SBS, an SBS Entity would be required to provide the counterparty with the midpoint between the bid and offer, or a calculated equivalent, as well as the methodology and assumptions used to prepare the daily mark.	Provision of a swap/SBS's mid-market value could be considered "advice" under proposed DOL regulations, which raises concerns for ERISA plans and could be considered advice or a recommendation under the CFTC's proposal. The SEC makes clear that providing a daily mark is not a "recommendation" and states that it is consulting with the DOL regarding these concerns.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Clearing (23.432) / (15Fh-3(d))	Would require a Swap Entity to notify any non-Swap/SBS Entity counterparty of its right to elect to have a swap cleared (if not required to be cleared) and to select the DCO.	Would require an SBS Entity to notify any non-Swap/SBS Entity counterparty of (i) its right to elect to have a swap cleared (if not required to be cleared), (ii) the clearing agencies for which the SBS entity has clearing privileges (either directly or indirectly), and (iii) its right to select the clearing agency from the list provided.	The SEC proposal, unlike the CFTC proposal, would limit the counterparty's choice of clearing agencies to ones in which the SBS Entity is a clearing member or has clearing privileges. The SEC proposal, unlike the CFTC proposal, would require the counterparty to express its intent to exercise its clearing rights prior to execution. Neither proposal is clear as to whether the counterparty's election to have a swap/SBS cleared and its choice of the clearing agency can affect the price of the swap/SBS.
Institutional Suitability			
Institutional Suitability Requirement (23.434(a)) / (15Fh-3(f)(1))	Would require a Swap Entity that makes any "recommendation" of a swap or trading strategy to any non-Swap/SBS Entity counterparty to have a reasonable basis to believe that such swap or trading strategy is suitable for that counterparty. The determination of suitability must be based on reasonable due diligence concerning the counterparty's financial situation and needs, objectives, tax status, ability to evaluate the recommendation, liquidity needs, risk tolerance, ability to absorb potential losses related to the recommended swap or trading strategy, and any other information known to the Swap Entity.	Would require an SBSD that makes any "recommendation" of an SBS or an SBS trading strategy to any non-Swap/SBS Entity counterparty to have a reasonable basis to believe that such SBS or trading strategy is suitable for at least some counterparties and that counterparty in particular. The determination of suitability must be based on reasonable due diligence concerning the counterparty's investment profile (including trading objectives) and its ability to absorb potential losses associated with the recommended SBS or trading strategy.	The SEC proposal would not apply to MSBSPs. The SEC's institutional suitability requirement would not apply to Special Entity counterparties if the SBSD is not acting as an advisor (e.g., by reason of the safe harbor where the Special Entity is represented by a qualified independent representative), thereby avoiding conflicts with the ERISA fiduciary rules. The institutional suitability requirement would also not apply if the SBSD is acting as an advisor to a Special Entity so long as the SBSD has complied with its best interests duty. The CFTC's requirement, however, would apply in addition to the other Special Entity requirements, including the "best interests" duty (see discussion of Special Entity provisions below).

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Definition of "Recommendation"	The CFTC explains that a "recommendation" would include "any communication" by which a Swap Entity "provides information to a counterparty about a particular swap or trading strategy that is tailored to the needs or characteristics of the counterparty." This would not include general transaction, financial, or market information or providing swap terms in response to a competitive bid request.	The SEC believes that the determination of whether an SBSD has made a recommendation should turn on the facts and circumstances of the situation, with particular attention to how tailored the communication is to the specific customer or group of customers. This is consistent with FINRA's approach, in which the relevant factors include whether the communication reasonably could be viewed as a "call to action" and whether it would reasonably influence an investor to trade a particular security or group of securities.[3]	The SEC, unlike the CFTC, makes clear that compliance with other business conduct requirements, e.g., disclosure of daily mark or clearing rights, would not in and of itself constitute a recommendation. Both Commissions acknowledge that determining if a communication is a "recommendation" is fact-specific and cannot be described by a bright line rule. However, the SEC would seemingly provide more leeway by discussing a spectrum of tailoring with greater tailoring being more likely to be considered a recommendation.
Alternative Method for Satisfying the Institutional Suitability Requirement (23.434(b)) / (15Fh-3(f)(2))	A Swap Entity would satisfy the requirement if: (i) the Swap Entity has a reasonable basis to believe that the counterparty (or its advisor) is capable of independently evaluating the risks related to the particular recommendation; (ii) the counterparty (or its advisor) affirmatively indicates that it is exercising independent judgment; and (iii) the Swap Entity has a reasonable basis to believe that the counterparty has the capacity to absorb potential losses related to the strategy.	An SBSD would satisfy the requirement if: (i) it reasonably determines that the counterparty (or its agent) is capable of independently evaluating investment risks with regard to the relevant SBS or trading strategy; (ii) the counterparty (or its agent) affirmatively represents in writing that it is exercising independent judgment in evaluating the recommendations by the SBSD; and (iii) the SBSD discloses that it is acting in the capacity of a counterparty, and is not undertaking to assess the suitability of the SBS or trading strategy.	The SEC, unlike the CFTC, states that an SBSD may rely on counterparty representations to satisfy the first two prongs of the test (see section on representations above). The SEC proposal would require the SBSD to disclose that it is acting as a mere counterparty. The CFTC proposal, coupled with the CFTC's proposal on representations, would require the Swap Entity to conduct due diligence to determine (i) the capability of the counterparty (or its advisor) and (ii) the counterparty's capacity to absorb losses.

[3] FINRA Notice to Members 01-23 (Mar. 19, 2001), and Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook, Exchange Act Release No. 62718 (Aug. 13, 2010), 75 Fed. Reg. 51310 (Aug. 19, 2010), as amended, Exchange Act Release No. 62718A (Aug. 20, 2010), 75 Fed. Reg. 52562 (Aug. 26, 2010) (discussing what it means to make a "recommendation").

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Special Entity Provisions			
Definition of "Special Entity" (23.401) / (15Fh-2(e))	Special Entity means: (i) A Federal agency; (ii) A State, State agency, city, county, municipality, or other political subdivision of a State; (iii) Any employee benefit plan, as defined in Section 3 of ERISA; (iv) Any governmental plan, as defined in Section 3 of ERISA; or (v) Any endowment, including an endowment that is an organization described in Section 501(c)(3) of the Internal Revenue Code.	Special Entity means: (i) A Federal agency; (ii) A State, State agency, city, county, municipality, or other political subdivision of a State; (iii) Any employee benefit plan, as defined in section 3 of ERISA; (iv) Any governmental plan, as defined in section 3(32) of ERISA; or (v) Any endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code.	The definitions are the same, with the exception of a section reference in prong (iv) of the definition. The SEC and the CFTC include similar requests for comment as to whether or not the definition should exclude plan asset funds, foreign plans, collective investment vehicles and single employer master trusts, and regarding the definition of "endowments."
Definition of "Act as an Advisor to a Special Entity" (22.440(a)) / (15Fh-2(a))	"Acts as an advisor to a Special Entity'' is defined to include instances where an SD recommends a swap or trading strategy that involves the use of swaps to a Special Entity. The term does not include instances where an SD provides general transaction, financial, or market information or swap terms in response to a competitive bid request from the Special Entity.	An SBSD acts as an advisor to a Special Entity when it recommends a swap or a trading strategy that involves the use of an SBS to the Special Entity, **unless** the following three conditions are met: (i) The Special Entity represents in writing that:	Although the base standard of making a "recommendation" is the same, the carve-outs are very different: Under the CFTC proposal, only general market information / responses to competitive bid requests is excluded from "recommendation."

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
		(1) The Special Entity will not rely on recommendations provided by the SBSD; and (2) The Special Entity will rely on advice from a qualified independent representative; and (ii) The SBSD has a reasonable basis to believe that the Special Entity is advised by a qualified independent representative; and (iii) The SBSD discloses to the Special Entity that it is not undertaking to act in the best interests of the Special Entity.	Under the SEC proposal, an SBSD that makes a recommendation to a Special Entity would **not** be an advisor if a three-part test is met. The three-part test requires representations from the Special Entity and disclosure from the SBSD. An SBSD would be entitled to rely on written representations of the Special Entity (see section on representations above). The SEC requests comments as to whether the term "advisor" should be defined, and if so, whether such definition should use formulations based on the standards applied to investment advisers, municipal advisors, or ERISA fiduciaries, or some other formulation. The SEC preamble cites the April 2011 letter from DOL Assistant Secretary Phyllis Borzi to CFTC Chairman Gary Gensler for the proposition that the determination of whether an SBSD is acting as an advisor for purposes of the business conduct rules is not intended to prejudice the determination of whether the SBSD is otherwise subject to regulation as an ERISA fiduciary. To the extent an SBSD avoids being deemed to be acting as an advisor to a Special Entity, it also avoids the special duties required of such an advisor, compliance with which might then trigger fiduciary status under ERISA.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
			In addition to considering whether an SD/SBSD is an "advisor" to a Special Entity under the CFTC or SEC proposed business conduct rules, any SD/SBSD that renders advice in connection with a swap should also consider whether such SD/SBSD would be subject to the obligations imposed on commodity trading advisors or investment advisers, under the CEA or the Investment Advisers Act, as applicable, or whether any available exclusion (such as for banks) would apply.[4]

[4] Subject to certain exclusions and exceptions, including exclusions for broker-dealers and banks, the term "commodity trading advisor" means any person who (i) for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in (I) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market or derivatives transaction execution facility; (II) any commodity option authorized under section 6c of the CEA; or (III) any leverage transaction authorized under section 23 of the CEA; or (ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i). See CEA Section 1a(12) (defining commodity trading advisor). Subject to certain exclusions and exceptions, including exclusions for broker-dealers and banks, an "investment adviser" includes any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. See Advisers Act Section 202(a)(11) (defining "investment adviser").

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Special Requirements for Dealers acting as Advisors to Special Entities. (23.440) / (15Fh-4)	Any SD that acts as an advisor to a Special Entity would be required to act in the best interests of the Special Entity and make reasonable efforts to obtain such information as is necessary to make a reasonable determination that any swap or trading strategy involving a swap recommended by the SD is in the best interests of the Special Entity. This information includes: • The authority of the Special Entity to enter into a swap; • The financial and tax status of the Special Entity; • The investment or financing objectives of the Special Entity; • The experience of the Special Entity with respect to swaps; • Whether the Special Entity has an independent representative that meets the qualifications set forth in the rule. • Whether the Special Entity has the financial capability to withstand potential losses; and • Any additional information that may be relevant.	Any SBSD that acts as an advisor to a Special Entity would be required to act in the best interests of the Special Entity and make reasonable efforts to obtain such information that the SBSD considers necessary to make a reasonable determination that an SBS or trading strategy involving an SBS is in the best interests of the Special Entity. This information shall include, but not be limited to: • The authority of the Special Entity to enter into a swap; • The financial and tax status of the Special Entity; • The investment or financing objectives of the Special Entity; • The experience of the Special Entity with respect to SBS; • Whether the Special Entity has the financial capability to withstand changes in market conditions during the term of the swap; and • Any additional information that may be relevant.	"Best interests" is not defined in either proposal. The CFTC notes that "there are established principles in case law" that would inform the meaning of "best interests" on a case-by-case basis. In discussing the meaning of "best interests" in the context of the Special Entity's representatives, the CFTC cites, among other standards, the requirements for ERISA fiduciaries.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
• **Reliance on Representations**	An SD would be able to rely on written representations of the Special Entity to satisfy the "reasonable efforts" requirement, so long as the SD has a reasonable basis to believe that the representations are reliable and the representations are sufficiently detailed for the SD to reasonably conclude that the Special Entity (i) is capable of evaluating independently the risks of the recommendation, (ii) is exercising independent judgment, and (iii) is capable of absorbing potential losses. An SD must also have a reasonable basis to believe that the Special Entity is represented by a qualified independent representative.	An SBS Entity could rely on written representations from the Special Entity. Upon receiving such representations, the SBS Entity would be entitled to rely on them without further inquiry, unless either (i) it knows that the representation is not accurate or (ii) it has information that would cause a reasonable person to question the accuracy of the representation. The SEC requests comment on whether (i) or (ii) is a more appropriate standard for reliance on representations.	
• **Exchange-Traded Swaps/SBS**	There is no exemption from these requirements for exchange-traded swaps under the CFTC proposal.	These requirements would not apply if the transaction is executed on a registered SBSEF or NSE and the SBSD does not know the identity of the counterparty, at any time up to and including execution of the transaction.	

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Definition of "Independent Representative of a Special Entity" (22.450(b)) / (15Fh-2(c))	A representative of a Special Entity would be deemed to be independent of the Swap Entity if: (i) The representative is not and was not (within the previous year) an associated person of the Swap Entity; (ii) There is no principal relationship between the representative of the Special Entity and the Swap Entity; and (iii) There is no "material business relationship" between the Swap Entity and the representative (whether or not compensatory), which would include any relationship that "reasonably could affect the independent judgment or decision making of the representative," with a one-year look back.	A representative of a Special Entity would be independent if the representative does not have a relationship with the SBS Entity, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the representative. A representative of a Special Entity would be deemed to be independent of an SBS Entity if: (i) The representative is not and, within one year, was not an associated person (for example an affiliate) of the SBS Entity; and (ii) The representative has not received more than ten percent of its gross revenues over the past year, directly or indirectly from the SBS Entity or its affiliates.	The CFTC proposal introduces new and unclear definitions of "principal relationship" and "material business relationship" and would require extensive disclosure of any compensation paid to the independent representative by the Swap Entity, including compensation unrelated to the swap. Unlike the CFTC proposal, the SEC proposal would include a safe harbor for the independence test. The SEC proposal would permit the SBS Entity to rely on representations to satisfy the independence requirement (see section on representations above).
Special Requirements for Dealers Acting as Counterparties to Special Entities. (23.450) / (15Fh-5)	A Swap Entity must have a reasonable basis to believe that the Special Entity has a qualified representative that meets the following requirements: • Has sufficient knowledge to evaluate the transaction and risks;	An SBS Entity must have a reasonable basis to believe that the Special Entity has a qualified representative that meets the following requirements: • Has sufficient knowledge to evaluate the transaction and risks;	As discussed above, there are key differences in the determination of "independence" under the SEC and CFTC proposals. The SEC requests comments regarding the qualifications of Special Entities' representatives, including whether a representative should be deemed "qualified" if it is a QPAM, INHAM, a registered municipal advisor or similar qualified professional.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
	• Is not subject to a statutory disqualification; • Is independent of the Swap Entity; • Undertakes a duty to act in the best interests of the Special Entity it represents; • Makes appropriate and timely disclosures to the Special Entity; • Evaluates, consistent with any guidelines provided by the Special Entity, fair pricing and the appropriateness of the swap; • In the case of an ERISA Plan, is a fiduciary as defined in Section 3 of ERISA; and • In the case of a municipal entity, is subject to restrictions on certain political contributions imposed by the CFTC, the SEC or an SRO.	• Is not subject to a statutory disqualification; • Is independent of the SBS Entity; • Undertakes a duty to act in the best interests of the Special Entity; • Makes appropriate and timely disclosures to the Special Entity of material information concerning the SBS; • Will provide written representations to the Special Entity regarding fair pricing and the appropriateness of the SBS; and • In the case of employee benefit plans subject to ERISA, is a fiduciary as defined in section 3(21) of ERISA; and • In the case of a state /municipal entity or governmental plan, is a person that is subject to rules of the SEC, the CFTC or an SRO subject to the jurisdiction of the SEC or the CFTC prohibiting it from engaging in specified activities if certain political contributions have been made.	

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
• **Reliance on Representations**	A Swap Entity would be entitled to rely on written representations to satisfy its obligation to have a "reasonable basis" to believe that the Special Entity has a qualified representative, so long as (i) the Swap Entity has a reasonable basis to believe that the representations are reliable and (ii) the representations are sufficiently detailed for the Swap Entity to reasonably consider and evaluate: • The nature of the relationship between the Special Entity and the representative; • The representative's capability to make hedging or trading decisions; • The use by the representative of one or more consultants; • The general level of experience of the representative in financial markets and specific experience with the instruments under considerations; • The representative's ability to understand the economic features of the swap involved; • The representative's ability to evaluate how market developments would affect the swap; and • The complexity of the swap involved.	An SBS Entity would be entitled to rely on written representations regarding the various qualifications of the independent representative to form a reasonable basis to believe that the independent representative is "qualified." Upon receiving such representations, the SBS Entity would be entitled to rely on them without further inquiry, unless either (i) it knows that the representation is not accurate or (ii) it has information that would cause a reasonable person to question the accuracy of the representation. The SEC requests comment on whether (i) or (ii) is a more appropriate standard for reliance on representations.	The SEC's standard for reliance on representations is more consistent with market practice and precedent, although the release poses numerous questions regarding reliance on representations from either the Special Entity or its representative, including whether additional diligence should be required for some or all Special Entities.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
• **Disclosure of Capacity**	Before the initiation of a swap, a Swap Entity would be required to disclose to the Special Entity in writing the capacity in which it is acting in connection with the swap. If the Swap Entity engages in business with the Special Entity in more than one capacity, it would be required to disclose the material differences between such capacities in connection with the swap and any other financial transaction or service involving the Special Entity.	Before initiation of an SBS, an SBS Entity would be required to disclose to the Special Entity in writing the capacity in which it is acting and, if the SBS Entity engages in business, or has engaged in business within the last twelve months, with the counterparty in more than one capacity, the SBS Entity would be required to disclose the material differences between such capacities in connection with the SBS and any other financial transaction or service involving the counterparty.	If an SBS Entity has acted in more than one capacity, the SEC proposal would require disclosure of material differences between such capacities in connection with the SBS and any other financial transaction or service involving the counterparty. This provision appears to require the SBS Entity to describe all other business relationships, even if not related to the particular SBS in any manner.
• **Exchange-Traded Swaps/SBS**	These requirements would not apply for swaps: (i) Initiated on a DCM or SEF; and (ii) One in which the Swap Entity does not know the identity of the counterparty to the transaction.	These requirements would not apply if the transaction is: (i) Executed on a registered SBSEF or NSE; and (ii) The SBS Entity does not know the identity of the counterparty, at any time up to and including execution of the transaction.	

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Compliance, Supervision, and Pay-to-Play			
SRO Membership	Would require a Swap Entity to become a member of one registered futures association, i.e., the National Futures Association (the "**NFA**"), which is currently the only such association.[5]	The SEC proposal would not (nor does the SEC believe it can) require non-broker-dealer SBS Entities to register with FINRA or another SRO.	In addition to CFTC regulations, Swap Entities may be required to comply with NFA rules. The CFTC proposal regarding treatment of confidential counterparty information (discussed above) would not provide an exception for disclosures that might be required by the NFA.
Supervision (23.602) / (15Fh-3(h))	Would require a Swap Entity to establish a system to supervise all personnel and activities relating to swaps and to identify an appropriate person with the authority to carry out the supervisory responsibilities.	Would require an SBS Entity to establish a system to supervise all personnel and activities relating to SBS and identify an appropriate person(s) with the authority to carry out the supervisory responsibilities. This system, including the supervisory personnel, must be described in writing.[6]	The SEC proposal is modeled on SRO rules and other rules applicable to broker-dealers. While the SEC proposal is more prescriptive than the CFTC proposal, the CFTC and the NFA may also look to SRO rules in enforcing compliance with the CFTC proposal.

[5] See CFTC Proposed Rule, Registration of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71379 (Nov. 23, 2010).

[6] Additionally, an SBS Entity must adopt written policies and procedures reasonably designed to achieve compliance with applicable securities laws, rules and regulations, and must include, at a minimum procedures: (i) for the review by a supervisor of all transactions for which registration as an SBS Entity is required and all related communications with counterparties; (ii) for a periodic review of the SBS business in which it engages; (iii) to conduct reasonable investigation into the background of associated persons; (iv) to monitor employee personal accounts held at another SBSD, broker, dealer, investment adviser, or other financial institution; (v) prohibiting supervisors from supervising their own activities or reporting to, or having their compensation or continued employment determined by, a person or persons they are supervising; (vi) preventing the standards of supervision from being reduced due to any conflicts of interest that may be present with respect to the associated person being supervised.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
		An SBS Entity or associated person would not have failed diligently to supervise a person if two conditions are met: (i) the SBS Entity has established policies and procedures reasonably designed to detect and prevent violations of the securities law related to SBS; and (ii) the supervisor has reasonably discharged his or her duties under the supervisory system without a reasonable basis to believe that the established procedures were not being followed.	However, in contrast to SRO rules, neither Commission has proposed to require registration of principals or other associated persons with the Commission or an SRO.
CCO (3.3(d)) / (15Fk-1)	Would require a Swap Entity and futures commission merchant ("**FCM**") to designate a qualified CCO, who must be listed as a principal of the registrant. A majority of the board (or the decision of the senior officer) would be required to approve the compensation or removal of the CCO.	Would require an SBS Entity to designate a CCO on its registration form. A majority of the board would be required to approve the compensation or removal of the CCO.	Dodd-Frank does not require majority board approval for decisions concerning the CCO, however, the SEC explains that it is proposing such a rule "to promote the independence and effectiveness of the CCO" and to address concerns "that an entity's commercial interests might discourage a CCO from making forthright disclosure to the board or senior officer about any compliance failures." Majority board approval stands in contrast to requirements applicable to other more senior executives for whom such approval is not required. It is not clear whether the SEC proposal adds meaningfully to existing incentive-based compensation guidelines issued by all of the prudential regulators, including the SEC.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Duties of the CCO (3.3(d)) / (15Fk-1(b))	In addition to the annual report described below, the CCO would be required to establish: (i) compliance policies including, among others, a code of ethics, risk management policies, and record retention procedures; (ii) remediation procedures for noncompliance; and (iii) procedures for handling, management response, remediation, retesting, and closing of noncompliance issues.[7] Additionally, the CCO would be required to: (i) report directly to, and meet annually with, the board or senior officer; (ii) review and ensure compliance with internal policies and all applicable rules pertaining to swaps; and (iii) resolve any conflicts of interest in consultation with the board or senior officer.	In addition to the annual report described below, the CCO would be required to: (i) report directly to the board or the senior officer; (ii) review the supervisory system (described above); (iii) resolve conflicts of interest in consultation with the board or senior officer;[8] (iv) administer each required policy and procedure (see footnote 6, above); and (v) establish, maintain and review policies and procedures reasonably designed (A) to ensure compliance with the provisions of the Exchange Act and rules thereunder pertaining to SBS, (B) to remediate promptly non-compliance issues identified by the CCO, and (C) for management response and resolution of non-compliance issues. [9]	The SEC defines the senior officer as the chief executive officer ("**CEO**") or an equivalent officer. This definition could be a problem for large institutions for which U.S. swap dealing is only one business line among many; the CFTC proposal does not define the term senior officer.

[7] The CFTC recognizes that the CCO has limited capacity and its proposed rule is not intended to alter the well-established corporate structure in which the board is the ultimate decision maker. Because of this, all compliance policies and procedures and the resolution of conflicts of interest are to be done in consultation with the board.

[8] The board or senior officer, not the CCO, would be responsible for ultimately making final decisions pertaining to conflicts of interest.

[9] The SEC explains that "the title of CCO does not, in and of itself, carry supervisory responsibilities. Consistent with current industry practice, we generally would not expect a CCO appointed in accordance with proposed Rule 15Fk-1 to have supervisory responsibilities outside of the compliance department. Accordingly, absent facts and circumstances that establish otherwise, we generally would not expect that a CCO would be subject to a sanction by the Commission for failure to supervise other SBS Entity personnel."

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Annual Report by the CCO (3.3(d)) / (15Fk-1(c))	The CCO would be required to prepare, sign and certify an annual report to be submitted to (i) the CFTC electronically and simultaneously with Form 1-FR-FCM or the FOCUS report of an FCM or the financial condition report of a Swap Entity and (ii) the board or senior officer (prior to CFTC submission). The CCO would be required to certify, under penalty of law, that to the best of his or her knowledge and reasonable belief the information contained in the report is accurate and complete.	The CCO would be required to prepare, sign and certify an annual report to be submitted to (i) the SEC simultaneously with each financial report required under Section 15F of the Exchange Act and (ii) the SBS Entity's board, audit committee and senior officer. The CCO would be required to certify, under penalty of law, that the report is accurate and complete.	Several differences between the proposals are the result of the SEC delineating specific written policies and procedures that must be adopted. Both proposals hold the CCO liable for inadequate or inaccurate annual reports but (i) the CFTC specifies that criminal liability is possible and (ii) the language of the SEC proposal seemingly calls for strict liability. The proposed SEC definition of "material compliance matter" would appear to deem any violation of the securities laws or internal policies a "material compliance matter", without regard to the seriousness or materiality of the violation.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
	The annual report must contain the following: (i) a description of the Swap Entity/FCM's compliance with the CEA, CFTC rules and internal policies and procedures; (ii) a review of each requirement under the CEA or CFTC rule and with respect to each (A) identification of the policies established to ensure compliance and (B) a discussion of areas that need improvement, recommended changes, and resources devoted to compliance; (iii) a list of changes to compliance policies since the last report; (iv) a certification of compliance with Dodd-Frank §§ 619 and 716 (limits on proprietary trading for banking entities and prohibition of federal assistance to swaps entities); (v) a description of resources (financial, managerial, operational and staffing) dedicated to compliance and any deficiencies; (vi) a delineation of the roles of the board, board committees, the senior officer, and staff in addressing conflicts of interest, including coordination with regulators and SROs that may be involved.	The annual report must describe the SBS Entity's compliance with the securities law as well as its compliance policies and procedures (including the code of ethics and conflict of interest policies). Additionally, at a minimum, the report must describe the enforcement of, material changes to, and recommendations concerning the SBS Entity's compliance policies and procedures. It must also describe any "material compliance matters" since the date of the preceding compliance report and contain a written representation that the CEO has conducted one or more meetings with the CCO concerning the SBS Entity's compliance program. A "material compliance matter" is any matter about which the board would reasonably need to know to oversee the compliance of the SBS Entity, including violations of securities law or internal policies and weaknesses in the supervisory system.	

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Conflicts of Interest/Information Barriers (CFTC rules proposed separately) / (15Fh-3(h)(2)(iv))	The CFTC proposes two rules—one for Swap Entities, the other for FCMs and introducing brokers—that require information partitions between persons serving different functions within the entity, conflict disclosures, and the implementation of policies and procedures to limit conflicts between research and trading and between clearing and trading.	Would require SBS Entities to adopt written policies and procedures reasonably designed to comply with the duties set forth in Section 15F(j) of the Exchange Act, as amended by Dodd-Frank. Section 15F(j)(5) of the Exchange Act requires the implementation of conflict-of-interest systems and procedures that "establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any security-based swap, or acting in the role of providing clearing activities, or making determinations as to accepting clearing customers are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards [addressed in Title VII of Dodd-Frank]."	The SEC proposal would allow SBS Entities to determine how best to comply with Dodd-Frank's requirements given their particular organizational structures, whereas the CFTC proposal defines several key terms and imposes specific prohibitions and limitations. The CFTC's broad definition of "research analyst," "research report," "clearing unit" and "business trading unit" would potentially restrict valuable information exchanges, such as transmitting trade ideas to customers, onboarding activities and credit risk management activities. The CFTC's requirement that Swap Entities and FCMs publicize written, objective criteria for the acceptance of clearing customers also may prevent qualitative judgments and risk assessments.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Risk Management Program, Monitoring of Positions and other Duties (CFTC rules proposed separately) / (15Fh-3(h)(2)(iv))	Would require Swap Entities to establish an integrated risk management program (overseen by an independent risk management unit that reports to the board) to address specified risks, including risks associated with new products. Additionally, Swap Entities would be required to adopt and comply with written procedures designed to (i) monitor compliance with positions limits, (ii) create a system of personnel supervisions, (iii) provide for business continuity in the event of a disaster, (iv) retain data that may be requested by the CFTC, and (v) prevent antitrust violations.	Would require SBS Entities to adopt written policies and procedures reasonably designed to comply with the duties set forth in Section 15F(j) of the Exchange Act, as amended by Dodd-Frank. Section 15F(j)(5) of the Exchange Act includes, among others, obligations concerning: (i) monitoring of trading to prevent violations of applicable position limits; (ii) establishing sound and professional risk management systems; (iii) disclosing to regulators information concerning trading in SBS; (iv) establishing and enforcing internal systems and procedures to obtain and produce necessary information; and (v) preventing antitrust violations.	The more flexible SEC proposal would avoid many of the issues raised in comments regarding the CFTC proposal, such as: • inconsistent requirements for Swap Entities that are separately required to adopt risk management systems by their prudential regulators; • narrow definition of "senior management" (only the CEO and officers who report directly to the CEO) that would prohibit certain officers who might be in the best position to monitor the risk management program from doing so; • broad definition of a "business trading unit" that would unnecessarily exclude well-situated personnel from performing risk management functions; • preventing trading supervisors to approve position limit exceptions; and • preventing tentative or preliminary approval of new products, as is customary now.

Provision	CFTC Proposal	SEC Proposal	Key Differences/Issues/Comments
Political Contributions (23.451(b)(1))/(15h-6)	Would prohibit: (i) swap activity with a municipal entity for two years following any contribution to an official of such municipal entity made by a Swap Entity or any covered associate[10] of the Swap Entity; (ii) paying a third party who is not a "regulated person" to solicit municipal entities; and (iii) soliciting or coordinating contributions to officials of a municipal entity with which a Swap Entity engages in or seeks to engage in swap activity. The prohibition would not be triggered for covered associates who make contributions of no more than $350 per election to any one official for whom the individual is allowed to vote and no more than $150 to an official for whom the individual is not entitled to vote.	Would prohibit: (i) SBS activity with a municipal entity for two years following any contribution to an official of such municipal entity made by an SBSD or any covered associate[11] of the SBSD; (ii) paying a third party who is not a "regulated person" to solicit municipal entities; and (iii) soliciting or coordinating contributions to officials of a municipal entity with which an SBSD engages in or seeks to engage in SBS activity. The prohibition would not be triggered for covered associates who make contributions of no more than $350 per election to any one official for whom the individual is allowed to vote and no more than $150 to an official for whom the individual is not entitled to vote.	The SEC and CFTC proposals are nearly identical but the SEC proposal would not apply to MSBSPs. Because the SEC/CFTC proposals differ somewhat from the proposed MSRB regulations (e.g., broader definition of "solicit", and application to swaps that are "offered" but not entered into) registrants would be required to comply with two sets of rules.[12]

[10] Covered associates would include certain officers and employees of the Swap Entity/SBSD who are either general partners, managing members or executive officers, or employees who solicit municipal entities on behalf of Swap Entities/SBSDs and any persons who supervise them. However, the prohibition would not apply to contributions by an individual made more than six months prior to becoming a covered associate of the Swap Entity/SBSD, unless such individual solicits the municipal entity after becoming a covered associate.

[11] See footnote 10, above.

[12] See MSRB Rule G-37, Political Contributions and Prohibitions on Municipal Securities Business.

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