

# SEC Proposes New Rules for Defining Security-Based Swap Execution Facilities

**February 4, 2011**

On February 2, 2011, the Securities and Exchange Commission (SEC) voted unanimously to adopt proposed rules under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act which would define security-based swap execution facilities (SEFs) and establish their registration requirements, as well as their duties and core principles.

Title VII of Dodd-Frank, among other things, (i) divides regulatory authority over swaps between the SEC and the Commodity Futures Trading Commission (CFTC) (with the SEC having regulatory authority over security-based swaps, the CFTC having regulatory authority over all other swaps, and joint regulatory authority over mixed swaps). Under Dodd-Frank, the SEC is authorized to implement a regulatory framework for security-based swaps, which currently trade exclusively in the over-the counter markets. Dodd-Frank requires security-based swaps to be cleared through a clearing agency if those transactions are of a type that the SEC determines must be cleared. Dodd-Frank does, however, exempt certain types of transactions from the clearing requirement (e.g., if one party to the transaction is not a financial entity, is using the swap to hedge or mitigate commercial risk, and notifies the SEC (in a manner set forth by the SEC)) how it generally meets financial obligations associated with entering into non-cleared security-based swaps).

Dodd-Frank provides that security-based swap transactions that are required to be cleared through a clearing agency must be executed on an exchange or on the newly created SEFs, and requires SEFs to be registered with the SEC. By requiring swaps to be traded on SEFs (or an existing exchange) the SEC hopes to create more transparency and fairness in the security-based swaps market. The SEC will seek public comment on the proposal until April 4, 2011.

The SEC's recent proposed rules include the following:

- ***Interpretation of the definition of “security-based SEFs” as set forth in Dodd-Frank.*** Under the proposed interpretation, an SEF would be a system or platform that allows more than one participant to interact with the trading interest of more than one other participant on the system or platform.
- ***Setting forth the registration requirements for security-based SEFs.*** The proposed rules would require SEFs to register with the SEC by filing a Form SB SEF. SEFs would be subject to annual filing requirements and also would make amended filings whenever the information on the Form SB SEF becomes materially inaccurate. The information to be provided on proposed Form SB SEF is designed to enable the SEC to assess whether an applicant has the capacity and the means to perform the duties of an SEF. Some of the information requested on the proposed Form SB SEF includes copies of governing documents, lists of officers and directors, organizational structure charts, ownership information and copies of audited financial statements.
- ***Implementation of the core principals for security-based SEFs outlined by Dodd-Frank.*** The proposed rules would require that SEFs have rules to ensure compliance with the core principals outlined in Dodd-Frank including, without limitation, making public post-trade information (e.g., price and trading volume) in a timely manner, maintaining records of activity relating to the facility’s business, and having a chief compliance officer who performs certain duties relating to the compliance monitoring of SEFs.
- ***Establishment of the process for SEFs to file rule changes and new products with the SEC.*** The proposed rules would require an SEF to submit new rule or rule amendments as rule filings either through a voluntary prior approval process or a self-certification process. The information that would be collected would help the SEC in overseeing the SEF’s compliance with its regulatory obligations. Likewise, the proposed rules would require an SEF to submit filings for new products that it makes available for trading either through a self-certification process or a voluntary prior approval process.
- ***Exemption of an SEF from the definition of exchanges and from most regulations as a broker.***

#### Related Professionals

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