



December 23, 2010

Via email to rule-comments@sec.gov

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Proposed Rule 9j-1; Release No. 34-63236; File No. S7-32-10

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association¹ (“**SIFMA**”) and the International Swaps and Derivatives Association, Inc.² (“**ISDA**” and, together with SIFMA, the “**Associations**”) appreciate the opportunity to comment on the Securities and Exchange Commission’s (the “**Commission**”) proposed Rule 9j-1³ under the Securities Exchange Act of 1934 (the “**Exchange Act**”). The Commission proposed Rule 9j-1 under Section 763(g) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank**”), which expands the antimanipulation provisions of Section 9 of the Exchange Act and authorizes the

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

² The International Swaps and Derivatives Association, or ISDA, was chartered in 1985 and has over 830 member institutions from 57 countries on six continents. Our members include most of the world’s major institutions that deal in privately negotiated derivatives, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the risks inherent in their core economic activities. For more information, visit: www.isda.org.

³ Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps, Exchange Act Release No. 63236 (Nov. 3, 2010), 75 FR 68560 (Nov. 8, 2010) (the “**Proposal**”).

Commission to adopt rules to prevent fraud, manipulation, and deception in connection with security-based swaps (“SBS”).

I. Introduction

The Associations strongly support the Commission’s goal of ensuring the integrity of the SBS market by deterring fraud and manipulation that could undermine investor confidence in the marketplace.⁴ The Associations believe that this goal is best achieved by applying the core elements of general securities antifraud proscriptions while taking into account unique characteristics of the SBS market. For many years, the securities antifraud provisions have provided the Commission with the tools needed to sanction and deter fraud and manipulation in options on equities and other securities derivatives, and for security based swap agreements. Likewise, investors have had the benefit of safe harbors, such as Rule 10b5-1 under the Exchange Act, which recognizes that predetermined trading does not present antifraud concerns. As discussed more fully below, to address differences between the SBS market and other securities, Congress supplemented the tools available to the Commission by amending the securities laws definitions of “purchase” and “sale” with respect to SBS. We support the application of this statutory approach to the SBS market.

However, we are concerned that proposed Rule 9j-1, in expanding beyond the statutory approach, is overly broad and creates significant market uncertainty. The expanded requirements of Rule 9j-1, in combination with existing Commission guidance and principles regarding antifraud and manipulation provisions (such as the “abstain or disclose” principle) seem profoundly at odds with the contractual payment and other performance obligations in SBS transactions. Consequently, proposed Rule 9j-1 falls short of the Commission’s goal of crafting a rule to prevent fraudulent and manipulative conduct in the SBS market “without interfering with or otherwise unduly inhibiting legitimate market or business activity.”⁵ The SBS market provides various benefits to the U.S. economy, including reducing borrowing costs and providing credit and financial risk management opportunities for corporations and institutional investors. The Commission should not adopt a rule that falls short of its own standard of not interfering with or otherwise unduly inhibiting legitimate market or business activity, as proposed Rule 9j-1 would do.

⁴ Proposal, at 75 FR 68564.

⁵ *Id.*

Two aspects of proposed Rule 9j-1, in particular, would discourage potential use of the SBS market:

- The Commission's discussion of SBS reference assets (referred to by the SEC in the Proposal as "reference underlyings") would seem to create enforcement exposure if a market participant continues to engage in legitimate cash market activities with respect to reference underlyings.
- Applying the rule to actions unrelated to SBS investment decisions and actions that occur pursuant to pre-agreed contractual terms is at odds with the established approaches under the securities antifraud provisions, including Rule 10b5-1, and would place counterparties in an untenable position. It would be the equivalent of concluding that an issuer making interest payments on a bond (or a bond holder accepting such payments) violated Rule 10b-5 because it was in possession of material nonpublic information – a consequence that Congress clearly did not intend.

Because of these two aspects of the proposed rule, market participants could be left in the position of either violating the antifraud rule by performing contracts when they are in possession of material nonpublic information, or abstaining from performance which means defaulting on their contracts. Given the conflict between complying with law and violating contracts, market participants could potentially withdraw from the market.

Proposed Rule 9j-1 is overbroad in other ways. For example, the proposed non-scienter standard of paragraphs (c) and (d) of the proposed rule is inconsistent with unique aspects of the SBS market. Subjecting every trading decision or payment under an SBS to an enforcement claim that someone knew or should have known that the action would operate as a fraud or deceit on a person could potentially deter many parties from entering into SBS, increase their cost and have other distorting effects on the markets. Given the vast number of trades and payments made under SBS made daily, the compliance process required for each such action would be overwhelming.

Moreover, the Associations believe that proposed Rule 9j-1 extends beyond the rulemaking authority granted in Section 763(g) and that, instead, a rule that accounts for the complexities of the SBS market is more likely to be within the scope of the Commission's authority under Dodd-Frank Section 763(g).

Given the seriousness of these issues, the Commission should further consider the differences between the SBS market and the cash securities market and engage in discussions with market participants and industry associations to ensure that it takes into account the operational characteristics of SBS before it adopts a final

rule. The SBS market is complex, both because of the nature of the instruments themselves and the way that SBS interact with the broader securities market. The overview of the SBS market provided below highlights aspects of the SBS market that are key to the comments in this letter, but there are additional details and nuances that are important to the operation of proposed Rule 9j-1. We are confident that after further consideration of these differences and the complexities of the SBS market, the Commission will be better able to fashion a rule that achieves Section 763(g)'s purpose without falling short of the Commission's own standard of not interfering with or otherwise unduly inhibiting legitimate market or business activity.

Background on the SBS Market. Congress recognized that the SBS market and SBS have unique characteristics not shared with securities or the security markets. An SBS confirmation marks the beginning, not the end, of a relationship between the two parties to an SBS and imposes significant ongoing performance obligations and rights that go far beyond the obligation in a securities purchase or sale to deliver, three days after trade date, cash or a security to the other party through a securities clearing house settlement system. An SBS lasts for a period of years, with three to five years being relatively standard, but much longer periods also are customary. Under an SBS, each party has ongoing performance obligations to the other, typically the obligation to make certain payments, and rights to receive them. In light of the nature of SBS as a continuing bilateral contract, the parties to it may, like all parties to a contract, wish to change the terms through amendment, assignment or early termination, which requires the affirmative agreement of both parties and an amendment to the written terms of an SBS. Payments under an SBS relate to a particular reference asset, may be bilateral or unilateral, and are set to occur periodically at specified intervals pursuant to an agreed upon formula, upon the occurrence of specific contractually agreed events in respect of the reference underlying, only at the termination of the SBS, or a combination of the foregoing. In the case of an SBS, the reference underlying may be an individual security or a narrow index of securities or loans.

Two categories of SBS of particular concern are credit default swaps (“CDSs”) and equity SBS. Upon entering into an SBS, counterparties are contractually obligated to make various periodic payments, including:

- **Interim Settlement/Reset Payments.** Parties generally agree to make periodic interim settlement payments under the SBS contract. For example, a two year equity SBS on XYZ security may have twenty-four monthly settlement payments, each based on the monthly total return performance of XYZ for a particular month. Buyers of CDS pay premiums on a quarterly basis.

- **Collateral Transfers.** Parties to SBS, including equity SBS and CDS, typically enter into a Credit Support Annex (“CSA”) or otherwise agree to provide collateral to cover the credit exposure of one party to the SBS to the other. Pursuant to such arrangements, initial margin may be paid upon initiation of the equity SBS. Variation margin payments are required thereafter based on a daily determination of credit exposure pursuant to an agreed process and formula.⁶
- **Substitute Dividend/Income Payments.** To replicate the total return of the underlying equity security or income streams associated with a loan or fixed income security, the party providing long exposure is obligated to make payments to the other party equal to any cash dividends (or other income received by a holder of the reference underlying). These payments are made throughout the duration of an SBS contract, and are triggered when such payments are declared or paid with respect to the reference underlying.
- **Corporate Actions.** Certain corporate actions (e.g., mergers, tender offers, stock dividends, rights offerings) may result in one party making a payment under an equity SBS contract. The method for calculating these payments is negotiated and agreed at the time the parties enter into an SBS contract. The occurrence of these actions is completely outside the control of the parties to an SBS contract. Corporate actions also lead to certain adjustments to the terms of a CDS contract.
- **Financing Payments.** These payments are made to the party providing long economic exposure to the underlying equity security to compensate such party for providing such exposure.

It is notable that under both CDS and equity SBS, once parties have agreed upon the terms of the instrument, the non-volitional actions described above are generally effected without any further decision making by the parties to the SBS. Other actions under an SBS may have a degree of volition but do not involve

⁶ Both bank regulators and the credit departments of market participants in the SBS markets have recognized that SBS create credit risk for each party to a SBS to the other in light of the ongoing payment performance obligations that typically last for a period of years. To mitigate this risk, and in the case of banking institutions, to fulfill regulatory requirements associated with safety and soundness, this credit exposure is carefully identified, monitored and managed. Collateralization of credit exposure, and netting of this exposure created by the existence of multiple SBS between the same parties, is recognized, and encouraged by the bank regulators, as a means of appropriately managing this credit risk. BASEL I, II and III all impose higher capital charges in respect of the credit risk created by SBS unless the parties have entered into legally enforceable netting and collateral arrangements. Market participants in connection with ISDA have established guidelines for such collateral arrangements and created standard documentation, the CSA, which market participants can customize to meet their needs.

investment decisions, such as certain protocols relating to settling an SBS after a triggering event and valuation of collateral. Similarly, to prudently manage credit exposure under an SBS, as well as to fulfill regulatory expectations related to safety and soundness and new requirements that will be effective under Dodd-Frank, parties to an SBS agree to maintain adequate levels of collateral in light of the credit exposure under the SBS pursuant to a collateral agreement, typically a CSA. The CSA establishes the methodology for collateral calculations and their payment. Failure to post collateral in the manner pre-agreed in the CSA is an event of default under the SBS. Thus, collateral decisions, such as requests for additional collateral, are essentially non-volitional.

In contrast, SBS parties during the life of the SBS may agree to take volitional actions that are related to investment decisions with respect to the SBS itself, such as terminating the SBS early, transferring their obligations and rights under the SBS to another party, or amending the terms that were originally agreed. The distinction between transactions effected pursuant to pre-agreed terms and future volitional acts related to investment decisions is of utmost importance for proposed Rule 9j-1. As discussed more fully below, the Commission's proposal does not account for this distinction, and as a result proposed Rule 9j-1 will have significant adverse effects on the SBS market and on the use of SBS.

II. Discussion

A. Application of Rule 9j-1 to Reference Underlyings Would Distort Market Behavior

The Proposal states that misconduct in the reference underlying that affects the price of an SBS could give rise to a violation of Rule 9j-1.⁷ The Commission would use a facts and circumstances analysis to determine whether actions with respect to a reference underlying have effects on an SBS that are "foreseeable" to the party engaging in such actions.⁸ Under current antifraud provisions, fraud or manipulation of the reference underlying to affect an SBS is illegal, and broker-dealers are prohibited from "front-running" customer orders. Nonetheless, the scope of proposed Rule 9j-1 and the stated "facts and circumstances" standard introduces untenable uncertainty as to when actions involving a reference underlying could be interpreted to be fraud in connection with an SBS.

⁷ It is notable that manipulative activity solely with respect to an underlying security is already covered by general securities law antifraud and antimanipulation laws and rules.

⁸ Proposal, at 75 FR 68564.

Trading in reference underlyings is an activity undertaken by many SBS market participants who transact in the cash market for reference underlyings as market makers and to fulfill customer orders, which may include block orders. Such trading, in particular with respect to block orders, may be viewed as having an impact on the price of the reference underlying. To the extent that a pre-agreed payment or determination of a collateral call relates to the market price of the reference underlying, market participants are concerned that their routine fulfillment of customer orders in the cash market could be argued to be “misconduct” under Rule 9j-1. It is also customary for market participants to hedge the risk exposure of an SBS by purchases and sales of the reference underlying. Fear of enforcement exposure under the vague standard of the proposed rule could potentially deter market participants from entering into SBS if they cannot appropriately hedge the resulting risk.

These concerns under Rule 9j-1 are not generally prevalent under current antifraud provisions. Today, if a dealer in an equity security writes an equity option to a customer on such security, the dealer is subject to antimanipulation rules with respect to its trading in the underlying. The dealer in the normal course of its market making activity executes customer orders and hedges the positions created on its own books as a consequence of its dealing activities. A dealer also may receive and execute customer block orders in the normal course of its business, and these block trades may arguably have an impact on the price of the security. The dealer’s behavior is not considered manipulative unless its trading in the reference underlying is intentionally distortive of the underlying market prices. The dealer is not required to disclose to the option holder its trading activity in executing orders for other customers in the reference underlying, even though the option holder might consider this information, and its impact on the price of the reference underlying, to be material. Conduct that does not create enforcement exposure or give rise to a disclosure obligation for equity options should not create enforcement exposure for an SBS.

Information Barriers We also note that information barriers may have little utility in the context of Rule 9j-1 as currently drafted, especially with respect to routine activities related to an SBS counterparty’s participation in the cash market for a reference underlying.

As the Commission is aware, information barriers are the basis upon which firms conduct trading activities in the cash securities, options and SBS markets while

simultaneously engaging in corporate capital raising and other customer transactions involving material nonpublic information.⁹

However, information barriers do not resolve the ambiguity regarding enforcement exposure from Rule 9j-1's application to trading in the reference underlying and the ongoing obligations and rights under an SBS contract. Information barriers in place today do not separate cash trading in reference underlyings from SBS trading or the performance of non-volitional or otherwise necessary actions under an SBS. There are many reasons that SBS and cash trading activities are not segregated, including that SBS traders also trade cash positions to hedge SBS risk exposure.¹⁰ Thus, there is a concern that ordinary course trading in reference underlyings, such as trading to facilitate customer orders or hedge a market participant's risk, that may have an impact on the price of the reference underlying could be viewed as manipulative with respect to an SBS, even if it is not manipulative with respect to the reference underlying. If so, market participants will be in a quandary, forced to choose between segregating trading in reference underlyings from SBS activities, or disclosing their reference underlying trading activities to each other.¹¹

Neither option is a tenable solution. Segregating reference underlying trading activities would require extensively restructuring the operations and information barrier procedures of most large financial institutions. In addition, such a restructuring would prohibit financial institutions from efficiently hedging or risk managing these instruments and could potentially cause them to limit participation in the SBS market. Moreover, we note that non-segregated trading in reference underlyings and SBS is an integrated way of investing in an asset class and such integrated trading is expected by customers. Disclosure is not

⁹ Firms receive material nonpublic information from issuers or others as part of merger or acquisition or other corporate advisory services or syndicated lending on the private side of the information wall. At the same time, the firms purchase and sell securities as market makers, dealers or broker-dealers for their customers in the public markets on the public side of the information wall, separated by appropriate procedures to prevent the transmission of material nonpublic or certain other confidential information from the private side to the public side.

¹⁰ Indeed, safety and soundness concerns and effective risk management practices essentially require that risks in SBS on a particular reference underlying be able to be efficiently hedged by transacting in the reference underlying itself.

For CDS and loan CDS, the only effective hedge often is the reference underlying, and so these are traded together for efficient hedging.

¹¹ Note that it would not be permissible under existing law to disclose to one customer the orders of another.

feasible because market participants are unlikely to be willing to share trading information with each other, are prohibited by law from doing so in many circumstances, and will be unwilling to receive confidential information. Thus, to avoid significantly reducing participation in the SBS market, the Commission should clarify that ordinary course, non-manipulative trading in reference underlyings would not, under Rule 9j-1, result in enforcement exposure or require disclosure regarding such activity to an SBS counterparty in order to avoid such exposure.

B. The Overbroad Application of Proposed Rule 9j-1 to Actions Unrelated to SBS Investment Decisions and the Overextension of Insider Trading Enforcement Exposure Will Unduly Inhibit Legitimate Market Business Activity

Overbroad Application of Rule 9j-1 to Non-Volitional and Other Necessary Actions. The Commission states that Rule 9j-1 is “intended to parallel the general antifraud provisions applicable to all securities, while also explicitly addressing the characteristics of cash flows, payments, deliveries, and other obligations and rights that are specific to security-based swaps.”¹² In fact, however, the Proposal’s attempt to address characteristics specific to SBS does not parallel the general antifraud provisions of the securities laws and fails to account for unique aspects of the SBS market. As a result, the proposal is substantially overbroad. If adopted as proposed, Rule 9j-1 would disrupt the operation of the SBS market and discourage SBS use.

The general antifraud provisions of the securities laws apply to a narrower range of events than proposed Rule 9j-1. The events that trigger the general antifraud provisions are offers, purchases and sales. These require affirmative actions relating to investment decisions, as opposed to actions flowing from rights of a security holder that are inherent in a security, such as the right to receive dividends, or from the pre-agreed contractual terms of an SBS.¹³ Consistent with the approach of the securities laws, under which insider trading prohibitions are applied to activities related to investment decisions, Dodd-Frank amended the securities laws to add to the definitions of “purchase” and “sale” other events in

¹² Proposal, at 75 FR 68564.

¹³ The Commission has previously recognized that antifraud concerns are specifically related to investment decisions. See Regulation FD Adopting Release, Securities Act Release No. 7881, Exchange Act Release No. 43154, Investment Company Act Release No. 24599 (Aug. 15, 2000), 65 FR 51716, 51721 (Aug. 24, 2000) (citing *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *Basic v. Levinson*, 485 U.S. 224, 231 (1988)) (stating that Regulation FD applies to information important in making an “investment decision”).

the life of an SBS that arise from affirmative actions by the parties. Specifically, Sections 761(a)(3) and (4) of Dodd-Frank amended the definitions of “purchase” and “sale” to include, with respect to SBS, the “execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing the rights or obligations under” an SBS.

Rule 9j-1 takes a very different, broader path. The Commission proposed that Rule 9j-1 apply to the exercise of *any* right or performance of *any* obligation under an SBS, and the avoidance of the exercise of *any* right or avoidance of performance of *any* obligation under an SBS.¹⁴ These events are often non-volitional or otherwise necessary and thus are far broader than the events covered by the general antifraud provisions, which have effectively governed the securities derivatives and security based swap agreement markets for many years. This distinction is just one of the issues that the SEC should carefully review before adopting a final rule. In its present form, the overbroad scope of proposed Rule 9j-1 would have a significant deleterious effect on the functioning of the SBS and securities markets.

Inconsistent with Rule 10b5-1. Rule 10b5-1 under the Exchange Act is grounded on the concept that predetermined actions do not present the same insider trading concerns as investment decisions based on material nonpublic information. Rule 10b5-1 provides an affirmative defense from the general insider trading rule if, among other things, a person can demonstrate that before becoming aware of material nonpublic information, the person had entered into a binding contract to purchase or sell a security, provided instructions to another person to execute the trade for the instructing person’s account, or adopted a written plan for trading securities. This safe harbor recognizes that insider trading concerns are not present when a transaction is executed pursuant to pre-agreed terms. The Commission should take a similar approach with respect to SBS and should not apply Rule 9j-1 to actions taken pursuant to the pre-agreed contractual terms of an SBS.

Overextension of Insider Trading Enforcement Exposure. By applying Rule 9j-1 to the exercise of all rights or performance of all obligations, and avoidance thereof, under an SBS, and not just to affirmative actions with respect to an SBS distinct from its contractual terms, the Commission very substantially increases the scope of enforcement exposure for participants in SBS. As described above, SBS are by nature ongoing relationships with many ongoing rights and

¹⁴ This is especially troubling as it could result in enforcement exposure without a person taking any affirmative action.

obligations that do not involve affirmative or truly discretionary actions. Applying an antifraud proscription to statements or omissions made arguably in connection with the exercise of these rights and obligations substantially changes the risk exposures arising from these relationships.

The potential for enforcement exposure under Rule 9j-1 increases materially and becomes unmanageable when combined with the insider trading principle of “disclose or abstain” when in possession of material nonpublic information. For example, we are concerned that under proposed Rule 9j-1, the “disclose or abstain” principle could apply in connection with ongoing periodic payments between SBS counterparties that are required by the terms of the contract.¹⁵

The “disclose or abstain” principle has been recognized by courts and the SEC for several decades, but only in connection with purchases and sales of securities.¹⁶ The disclose or abstain principle is premised upon a party having a choice to disclose material nonpublic information or abstain from transacting. If an action is unavoidable as a part of pre-agreed contractual terms of an SBS, effectively there is no choice between disclosing and abstaining and the very application of the principle is inapposite. Proposed Rule 9j-1 does not recognize this distinction. Under proposed Rule 9j-1, parties to an SBS could be required to disclose information to each other in a way that counterparties do not expect, and given the restrictions attendant to receipt of material nonpublic information, are likely to not want.¹⁷ When faced with this unwelcome prospect, market participants will be extremely hesitant to enter into an SBS. Rule 9j-1 would not have this chilling effect if it were drafted narrowly to apply only to the specific investment decision activities added to the definitions of purchase and sale – execution, termination, assignment, exchange, or similar transfer or conveyance of, or extinguishing the rights or obligations under an SBS.¹⁸

¹⁵ *See, e.g.*, *Chiarella v. United States*, 445 U.S. 222 (1980) (holding that when a duty to disclose runs between parties to a transaction, non-disclosure can give rise to fraud under Section 10(b) of the Exchange Act). We note that in the absence of any duty between the parties to a transaction, the disclose or abstain principle does not apply.

¹⁶ *See, e.g.*, *Speed v. Transamerica Corp.*, 71 F. Supp. 457 (D. Del. 1947) (holding that it is unlawful under Rule 10b-5 for an insider to purchase stock without disclosing material facts affecting the value of the stock by virtue of his inside position); *Cady, Roberts & Co.*, 40 SEC 907 (1961) (holding that trading in the open market by insiders based on material nonpublic information is a violation of Rule 10b-5).

¹⁷ We also note that such disclosure would violate commitments made to customers to keep their information confidential.

¹⁸ We recognize that in light of SBS’ status as securities, transactions in SBS will be subject to Rule 10b-5. Thus, the Commission should clarify that Rule 10b-5 does not apply to an (...continued)

The Negligence Standard of Proposed Rule 9j-1(c) and (d) Does Not Account for Unique Aspects of the SBS Market. Paragraph (c) of proposed Rule 9j-1 makes it unlawful for a person to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. Paragraph (d) makes it unlawful to engage in any act, practice, or course of business which operates or would operate as fraud or deceit upon any person. The Commission states that violations of paragraphs (c) and (d) would not require scienter, and, as to paragraph (c), would extend to conduct that is “at least negligent.”

The proposed non-scienter standard,¹⁹ coupled with the rights and responsibilities provision and enforcement exposure for omissions of disclosure, potentially would make illegal a wide range of ordinary course activities that may relate to an SBS transaction. For example, because the proposed rule applies to ongoing payments made pursuant to the pre-agreed contractual terms of an SBS, enforcement exposure could result under a negligence standard if a party to an SBS makes a mistake in calculating a payment that is due under the SBS, as such a party could be seen as “obtaining” money by means of a negligently untrue statement. Like any high volume business, mistakes in calculating payments are not uncommon due to human error; but today any such mistakes are identified and resolved between counterparties without exposure to antifraud enforcement exposure. In addition, if payments pursuant to pre-agreed contractual terms are delayed, back and middle office departments often work to reconcile any confusion and agree upon a solution without the worry of potential antifraud enforcement exposure. Every trading decision would be subject to the claim the trader knew or should have known that the trade would operate as a fraud or deceit on a person. The specter of increased enforcement exposure potentially will deter many parties from entering into SBS, increase their cost and have other distorting effects on the markets. Given the vast number of trades and payments

(continued...)

SBS with respect to the exercise of *any* right or obligation under an SBS, for the same reasons as noted above with respect to Rule 9j-1, even though Rule 10b-5 would apply to the “execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing the rights or obligations under” an SBS.

In addition, the Commission should confirm that the rule does not require specific disclosures regarding a market participant’s unrelated trading activities upon entering into an SBS.

¹⁹ It should be noted that antifraud provisions typically require scienter, or, at least, recklessness. A lesser standard is inconsistent with the concept of fraud.

made daily in the markets, the compliance process required for each such action would be overwhelming.

C. *The Proposal Exceeds the Commission's Rulemaking Authority*

As proposed, Rule 9j-1 exceeds the Commission's rulemaking authority under Dodd-Frank Section 763(g). Section 763(g) prohibits a person from using fraudulent, deceptive, or manipulative acts or practices to "effect any transaction in, or to induce or attempt to induce the purchase or sale of" an SBS. The Commission is authorized to adopt rules reasonably designed to prevent "such transactions, acts, practices and courses of business as are fraudulent, deceptive, or manipulative."

Proposed Rule 9j-1 extends far beyond the rulemaking authority granted in Section 763(g). Although Dodd-Frank amended the securities laws definitions of "purchase" and "sale" to include, with respect to SBS, the "execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing the rights or obligations under" an SBS, proposed Rule 9j-1's proscription of the exercise or avoidance of exercise of *any* right or responsibility is not authorized under Section 763(g)'s "in connection with" requirement. These new statutory elements each relate to subsequent investment decisions with respect to the SBS itself (such as a future sale or extinguishing of the contract) rather than the performance of the pre-agreed terms of the SBS. The rulemaking authority provided by Section 763(g) only extends to transactions, acts, practices, or courses of business in connection with (i) effecting any transaction in an SBS and (ii) inducing or attempting to induce the purchase or sale of an SBS.

Rule 9j-1 exceeds this authority in several ways. First, performing a contract that has been previously agreed upon does not constitute "effecting" a transaction in an SBS. By its plain meaning the phrase "effect any transaction in" refers to entering into an SBS in the first instance. This conclusion is supported by the coupling of the phrase with the reference to inducing or attempting to induce the purchase or sale of an SBS, showing that Congress intended to cover both the act of entering into a transaction ("effecting") and the behavior that precedes entering into a transaction ("inducing"). Second, proposed Rule 9j-1's application of antifraud provisions to the exercise of *any* right or performance of *any* obligation under a security-based swap, or the avoidance of such exercise or performance regarding an SBS is not in connection with a transaction, purchase or sale of a SBS because the definition of purchase or sale is limited to the express actions noted above. Therefore, the Proposal exceeds the rulemaking authority granted to the Commission under Dodd-Frank Section 763(g) and should be revised accordingly before final adoption.

III. Conclusion

The Associations support the Commission's goal of adopting antifraud standards to ensure the integrity of the SBS market. However, for the reasons discussed above, we believe that Rule 9j-1 is overbroad and may discourage use of the SBS market by all participants, harming both the securities markets and the broader U.S. economy.

We recommend that before adopting a final rule the Commission further consider the differences between the SBS market and the traditional securities market and the issues highlighted herein. After doing so, the Commission should fashion a final rule that is narrowly tailored to achieve its purpose without having significant negative effects on the securities markets, and that is within the scope of its authority under Dodd-Frank Section 763(g). Specifically, based on a fuller understanding of the SBS market, the Commission should modify proposed Rule 9j-1 by limiting its scope to those specific activities enumerated in the expanded definitions of the terms purchase and sale, and limiting the application of omissions-based insider trading enforcement exposure to affirmative actions involving scienter. We would welcome the opportunity to discuss these very important issues with the Commission.

Sincerely yours,



Kenneth E. Bentsen, Jr.
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