SECURI

17 CFR Part 240

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Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is adopting a final rule, under the Securities Exchange Act of 1934 ("Exchange Act"), that is designed to prevent fraud, manipulation, and deception in connection with effecting any transaction in, or attempting to effect any transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap. The rule takes into account the features fundamental to a security-based swap and the broad definitions of purchase and sale under the Exchange Act as they relate to security-based swaps. In addition, the Commission is adopting a final rule, under the Exchange Act, that makes it unlawful for any officer, director, supervised person, or employee of a security-based swap dealer ("SBSD") or major security-based swap participant ("MSBSP") (each SBSD and each MSBSP also referred to as an "SBS Entity" and together referred to as "SBS Entities"), or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the SBS Entity's chief compliance officer ("CCO") in the performance of their duties under the Federal securities laws or the rules and regulations thereunder.

DATES: *Effective date*: [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION: First, the Commission is adopting 17 CFR 240.9j-1 ("Rule 9j-1") under the Exchange Act, which is a new rule designed to prevent fraud, manipulation, and deception in connection with effecting transactions in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap. The Commission is also adopting 17 CFR 240.15fh-4(c) ("Rule 15fh-4(c)") under the Exchange Act, which is a new rule making it unlawful for any officer, director, supervised person, or employee of an SBS Entity, or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the SBS Entity's CCO in the performance of their duties under the Federal securities laws or the rules and regulations thereunder.

I. Introduction

A. Background

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[1] provided the Commission with primary responsibility for regulating security-based swaps. A person who satisfies the definitions of "security-based swap dealer" or "major security-based swap participant" is required to register with the Commission in such capacity and is therefore subject to the Commission's regime regarding, among other things, internal supervision requirements and the requirement to designate an individual to serve as the CCO.[2] In addition to other requirements, the CCO must take reasonable steps to ensure that the SBS Entity establishes, maintains, and reviews written policies and procedures reasonably designed to

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[1] Wall Street Transparency and Accountability Act of 2010, Pub. L. No. 111–203, sections 761-774, 124 Stat. 1376, 1754-1802 (2010). Unless otherwise indicated, references to "Title VII" in this release are to subtitle B of title VII of the Dodd-Frank Act.

[2] *See, e.g.*, 17 CFR 240.3a71-1 (Definition of "security-based swap dealer"); 17 CFR 240.3a71-2 (De minimis exception for SBSD registration); 17 CFR 240.3a67-1 (Definition of "major security-based swap participant"); 17 CFR 240.15Fb2-1 (Registration of SBSDs and MSBSPs); 17 CFR 240.15Fh-3 (Business conduct requirements for SBSDs and MSBSPs).

achieve compliance with the Exchange Act and the rules and regulations thereunder relating to its business as an SBS Entity.[3]

The Dodd-Frank Act also amended the Exchange Act in a number of important ways to prohibit fraud, manipulation, and deception in connection with security-based swaps. In particular, section 763(g) of the Dodd-Frank Act expanded the anti-manipulation provisions of section 9 of the Exchange Act to encompass purchases or sales of security-based swaps and requires the Commission to adopt rules to prevent fraud, manipulation, and deception in connection with security-based swaps.[4] Specifically, paragraph (j) of section 9 makes it unlawful for "any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange, to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security-based swap, in connection with which such person engages in any fraudulent, deceptive, or manipulative act or practice, makes any fictitious quotation, or engages in any transaction, practice, or course of business which operates as a fraud or deceit upon any person."[5] It also provides that the Commission "shall . . . by rules and regulations define, and prescribe means reasonably designed to prevent, such transactions, acts, practices, and courses of business as are fraudulent, deceptive, or manipulative, and such quotations as are fictitious."[6]

Additionally, section 761 of the Dodd-Frank Act modified several definitions in both the Exchange Act and the Securities Act of 1933 ("Securities Act") to account for security-based swaps.[7] For example, the Dodd-Frank Act amended the definition of "security" in section

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3 *See* 17 CFR 240.15Fk-1; Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 77617 (Apr. 14, 2016), 81 FR 29960 (May 13, 2016) ("Business Conduct Standards Adopting Release").

4 *See* 15 U.S.C. 78i(j).

5 *See id*. Note that section 9 of the Exchange Act erroneously contains two subsection (j)s.

6 *See id*.

7 Section 3(a)(68) of the Exchange Act defines "security-based swap." 15 U.S.C. 78c(a)(68).

3(a)(10) of the Exchange Act[8] and section 2(a)(1) of the Securities Act[9] to include security-based swaps. As a result, security-based swaps, because they are securities, are subject to the general antifraud and anti-manipulation provisions of the Federal securities laws, including sections 9(a) and 10(b) of the Exchange Act, and 17 CFR 240.10b-5 ("Rule 10b-5") thereunder,[10] and section 17(a) of the Securities Act.[11]

Moreover, the Dodd-Frank Act amended the definitions of "purchase" and "sale" in section 2(a)(18) of the Securities Act,[12] the definitions of "buy" and "purchase" in section 3(a)(13) of the Exchange Act,[13] and "sale" and "sell" in section 3(a)(14) of the Exchange Act,[14] in the context of security-based swaps, to include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require. As a result of those changes, misconduct in connection with these actions is also prohibited under sections 9 and 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and section 17(a) of the Securities Act.

On December 15, 2021, the Commission re-proposed antifraud and anti-manipulation rules,[15] as required by section 9(j) of the Exchange Act. The re-proposal followed the

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8 15 U.S.C. 78c(a)(10).

9 15 U.S.C. 77b(a)(1).

10 15 U.S.C. 78j(b).

11 15 U.S.C. 77q(a).

12 15 U.S.C. 77b(a)(18).

13 15 U.S.C. 78c(a)(13).

14 15 U.S.C. 78c(a)(14).

15 *See* Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions, Exchange Act Release No. 93784 (Dec. 15, 2021), 87 FR 6652 (Feb. 4, 2022) ("2021 Proposing Release"). *See also* 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) ("2010 Rule 9j-1 Proposing Release"). For purposes of this release, we will refer to the version of Rule 9j-1 that the Commission proposed in the 2010 Rule 9j-1 Proposing Release as the "2010 Proposed Rule." We will refer to re-proposed Rule 9j-1 as "proposed rule" or "re-proposed Rule 9j-1"and to final Rule 9j-1 as "Rule 9j-1," "final rule," or "final Rule 9j-1."

Commission's adoption of much of its Title VII rulemaking related to security-based swaps,[16] as well as developments in the security-based swap market, including manufactured credit events or other opportunistic strategies in the credit default swap ("CDS") market, as discussed in section I.B below.[17] In addition, in recognition of the fact that CCOs of SBS Entities play an important role in preventing fraud and manipulation by SBS Entities and their personnel, the Commission proposed an additional measure under section 15F(h) of the Exchange Act[18] to protect CCOs in the furtherance of those duties.[19] The Commission is adopting Rule 9j-1 with modifications in response to commenters,[20] and adopting Rule 15fh-4(c) as proposed.[21] In developing this

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16 As more fully described in the 2021 Proposing Release, the Commission has now completed a majority of its rulemaking under Title VII, SBS Entities are required to register with the Commission (as of June 7, 2023, there are 50 conditionally registered security-based swap dealers), and all persons are required to report their security-based swap transactions to security-based swap data repositories. *See* 2021 Proposing Release, 87 FR at 6653 nn.2-4 and accompanying text. Further, since 2010, regulators overseeing the world's primary over-the-counter ("OTC") derivatives markets have made significant progress implementing reforms for OTC derivatives and the Commodity Futures Trading Commission ("CFTC") has largely completed its Title VII rulemakings related to swaps, including the adoption of antifraud and anti-manipulation rules. *See* 2021 Proposing Release, 87 FR at 6654-55, 6654 n.19.

17 *See infra* section I.B.2, describing in more detail manufactured credit events and other opportunistic strategies in the CDS market. *See also* 2021 Proposing Release, 87 FR at 6654-55. Additionally, in section II.C.2, *infra*, the Commission addresses concerns raised by commenters with regard to the application of Rule 9j-1 to legitimate credit activity or other activity in connection with security-based swap transactions, some of which may fit the descriptions of the manufactured credit events and other opportunistic strategies described in the 2021 Proposing Release.

18 *See* 15 U.S.C. 78*o*-10(h).

19 *See* 2021 Proposing Release, 87 FR at 6664-65. To be clear, the ultimate responsibility for compliance by the SBS Entity with the Federal securities laws, including the requirement to have adequate compliance systems and to avoid violations generally, rests with the SBS Entity itself.

20 The comment letters are available at http://www.sec.gov/comments/s7-32-10/s73210.shtml. The Commission also received comments on topics outside the scope of the proposal that are not addressed in this release. *See, e.g.*, Comment from Anonymous, dated Feb. 6, 2022, available at https://www.sec.gov/comments/s7-32-10/s73210-20114041-266299.htm (discussing dark pools); Comment from Anonymous, dated Dec. 16, 2021, available at https://www.sec.gov/comments/s7-32-10/s73210-20109790-264127.htm (discussing securities lending).

21 As described in greater detail below, the Commission is making several changes to proposed Rule 9j-1 and adopting Rule 15fh-4(c) as proposed. First, the Commission is revising paragraph (a) to more closely track the language of section 9(j) of the Exchange Act with regard to the conduct subject to the prohibitions of final Rule 9j-1(a), moving the prohibitions on attempted conduct from paragraphs (a)(3) and (a)(4) to a new paragraph (a)(5), and clarifying that the Commission believes scienter is the proper standard to apply to violations of paragraph (a)(5). *See infra* sections II.A and II.B. In addition, the Commission is moving paragraph (b) of proposed Rule 9j-1 to a new paragraph (a)(6) to rely on the scope of conduct subject to the prohibitions of paragraph (a). *See infra* section II.C. Finally, the Commission is adopting two affirmative defenses to violations of Rule 9j-1, one for actions taken in connection with binding rights and obligations under security-based swap documentation and one for appropriate policies and procedures to ensure compliance with Rule 9j-1 such as restrictions on access to material nonpublic information. *See infra* sections II.E.2.a and II.E.2.b. The Commission is not adopting the proposed safe harbor for portfolio compression exercises. *See infra s*ection II.E.2.c.

rulemaking we have consulted and coordinated with the CFTC and the prudential regulators in accordance with section 712(a)(2) of the Dodd-Frank Act.[22] Nothing in Rule 9j-1 alters the application of sections 9(a) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and section 17(a) of the Securities Act, including to misconduct that is in connection with the exercise of any right or performance of any obligation under the security-based swap.

The Commission also proposed for comment a new Rule 10B-1,[23] which would require any person with a security-based swap position that exceeds a certain threshold to promptly file with the Commission a schedule disclosing certain information related to its security-based swap positions. The Commission is not finalizing Rule 10B-1 in this release as it continues to consider comments received in connection with proposed Rule 10B-1.

B. Overview of Security-Based Swaps

1. Security-Based Swaps Generally

Although the definition of security-based swap is detailed and comprehensive,[24] at its most basic level, a security-based swap is an agreement, contract, or transaction in which two parties agree to the exchange of payments or cash flows based upon the value of other assets or upon the occurrence or non-occurrence of some event, including, for example, a change in a stock price or the occurrence of some type of credit event.[25] The exchange of these payments or

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22 In addition, in accordance with section 752 of the Dodd-Frank Act, the Commission has consulted and coordinated with foreign regulatory authorities through Commission staff participation in numerous bilateral and multilateral discussions with foreign regulatory authorities addressing the regulation of OTC derivatives markets.

23 *See* 2021 Proposing Release, 87 FR at 6667-76.

24 *See* 15 U.S.C. 78c(a)(68) (defining "security-based swap"). *See also* Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release No. 67453 (July 18, 2012), 77 FR 48208, 48211 (Aug. 13, 2012) ("Product Definitions Release") (further defining certain terms related to the definition of "security-based swap").

25 *See generally* section 3(a)(68) of the Exchange Act, which defines a "security-based swap" as any agreement, contract, or transaction that is a swap as defined in section 1(a) of the Commodity Exchange Act that is based on a narrow-based security index, or a single security or loan, or any interest therein or on the value thereof, or the occurrence or non-occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial instruments, financial condition, or financial obligations of the issuer. 15 U.S.C. 78c(a)(68). *See also* 2010 Rule 9j-1 Proposing Release, 75 FR at 68561 (generally discussing the definition of "security-

deliveries, including purchases or sales upon certain events, is a fundamental aspect or feature of a security-based swap.[26] Moreover, this feature of security-based swaps is in contrast to secondary market transactions involving equity or debt securities where the completion of a purchase or sale transaction terminates the mutual obligations of the parties. Security-based swap counterparties, who are considered the issuers of the security-based swaps, continue to have obligations to one another throughout the life of the instrument, which can extend for years if not decades.[27]

Parties may enter into a security-based swap for a multitude of reasons, but often, the parties to the contract seek to gain exposure to an asset without owning it or to manage or transfer risks in their asset and liability portfolios (*e.g.*, credit or equity risks). Typical participants in the security-based swap market include, among others, lenders transferring credit risk,[28] insurance companies managing asset and liability risk specific to the insurance industry,[29] activists or hedge funds obtaining exposure to the price movement and dividend payments of a stock without the costs and burdens of stock ownership,[30] and financial institutions that engage in

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based swap"). This section also discusses examples of security-based swaps and the exchange of payments or deliveries, or the purchase or sale or other payments upon the occurrence of a specific event, between the parties during the life of a security-based swap.

26 The definition of security-based swap requires that the instrument first meet the definition of swap in section 1a(47) of the Commodity Exchange Act. *See* 15 U.S.C. 78c(a)(68); *supra* note 25. That definition provides, inter alia, that a swap is an agreement, contract, or transaction that provides for *any purchase, sale, payment, or delivery* upon the occurrence or nonoccurrence of certain events or that provides on an executory basis for *an exchange on a fixed or contingent basis, of one or more payments* that meet certain conditions. *See* 7 U.S.C. 1a(47)(ii) and (iii).

27 *See* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," Exchange Act Release No. 66868 (Apr. 27, 2012), 77 FR 30596, 30616-17 (May 23, 2012) ("In contrast to a secondary market transaction involving equity or debt securities, in which the completion of a purchase or sale transaction can be expected to terminate the mutual obligations of the parties to the transaction, the parties to a security-based swap often will have an ongoing obligation to exchange cash flows over the life of the agreement.").

28 *See, e.g.*, Letter from Elliot Ganz, Loan Syndications and Trading Association ("LSTA"), dated Mar. 17, 2022 ("LSTA Letter"), at 2-3.

29 *See* Letter from Michael Lovendusky, American Council of Life Insurers ("ACLI"), dated Mar. 21, 2022 ("ACLI Letter").

30 *See* Letter from Richard B. Zabel, Elliott Investment Management L.P., dated Mar. 21, 2022 (addressing concerns related to proposed Rule 10B-1 but also describing the security-based swap activity of activists and hedge funds).

market-making and dealing in security-based swaps.[31] The terms of the contract between the counterparties determine the specific rights and obligations of the parties throughout the life of the security-based swap, including, for example, the amount and timing of periodic payments due under the instrument, the maturity of the instrument, and terms of settlement. Counterparties to a security-based swap typically use a standardized agreement published by ISDA, first in 1992 and updated in 2002, which is the most widely used contract setting forth the terms of security-based swap transactions (the "ISDA Master Agreement"). Unlike other types of securities where settlement occurs when the buyer receives the security purchased and the seller receives cash equaling the value of the security sold, for security-based swaps, a final net payment is paid by one party to the other at a future point in time to which the parties have contractually agreed.[32]

Two common examples of security-based swaps – credit default swaps ("CDS") and total return swaps ("TRS") – are described in more detail below.[33]

Generally, a CDS is a contract in which a party (the "protection buyer"), such as a lender, agrees to make periodic payments (the "premium") over an agreed upon time period to another party (the "protection seller") in exchange for a payment from the protection seller in the event of default by an issuer (or group of issuers) of securities (the "reference entity").[34] The CDS contract states whether the CDS is settled physically or in cash in the event of default by the

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31 *See* Letter from Bridget Polichene, Institute of International Bankers ("IIB"), Scott O'Malia, International Swaps and Derivatives Association ("ISDA"), and Kenneth E. Bensten, Jr., Securities Industry and Financial Markets Association ("SIFMA"), dated Mar. 21, 2022 ("IIB-ISDA-SIFMA Letter").

32 *See*, *e.g.*, Shortening the Securities Transaction Settlement Cycle, Exchange Act Release No. 96939 (Feb. 15, 2023), 88 FR 13872, 13878 (Mar. 6, 2023) ("T+1 Adopting Release") (citing letter from Thomas Price, Managing Director, and Lindsey Weber Keljo, Head – Asset Management Group, Securities Industry and Financial Markets Association re: File No. S7-05-22 (Apr. 13, 2022), at 11).

33 The definition of security-based swap in the Exchange Act and the rules thereunder is broad. *See supra* notes 25-26 and related discussion. The application of the rules we adopt in this document is not limited to CDS and TRS or to transactions between particular types of counterparties.

34 A CDS generally falls within the second prong of the definition of a swap under section 1(a) of the Commodity Exchange Act as a contract "that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence." *See* 7 U.S.C. 1a(47)(a)(ii). If the CDS falls within any of the prongs of the definition of security-based swap in Exchange Act section 3(a)(68)(A)(ii), the CDS would be a security-based swap. *See* Product Definitions Release, 77 FR at 48267, and the broader discussion of CDS therein.

reference entity. Generally, the protection buyer is using the CDS to manage risk and the protection seller is using the CDS to take on risk in return for a premium. A cash-settled CDS contract relying on ISDA documentation is subject to determinations by a committee with respect to whether a defined default event (a "credit event") has occurred and, if so, to hold an auction to determine the settlement price of the CDS. The auction process includes the determination and publication of a list of deliverable obligations that a CDS protection buyer can deliver to the CDS protection seller after the auction settlement. A CDS protection buyer can deliver any of the obligations on the list, with delivery of the cheapest deliverable obligation maximizing recovery.[35] This feature of CDS contracts is an aspect of some of the manufactured or opportunistic strategies discussed in section I.B.2.

In contrast, a TRS may obligate one of the parties (*i.e.*, the total return payer) to transfer the total economic performance (*e.g.*, income from interest and fees, gains or losses from market movements, and credit losses) of a reference asset (*e.g.*, a debt or equity security) (the "reference underlying"), in exchange for a specified or fixed or floating cash flow (including payments for any principal losses on the reference asset) from the other party (*i.e.*, the total return receiver).[36] If the TRS is negotiated over-the-counter, the terms of the TRS can be individually negotiated

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35 *See* 2021 Proposing Release, 87 FR at 6655 n.23. As described in the 2021 Proposing Release, in order to cash settle any CDS contract that relies on the ISDA standard documentation, a Credit Derivatives Determinations Committee ("DC") must make a determination that a credit event occurred and vote to hold an auction to determine the settlement price of the CDS. A DC is generally composed of nine or ten dealers and five buy-side members. Once a DC determines that a credit event has occurred and that an auction should be held, the DC Secretary publishes auction terms, which include a list of obligations that a CDS protection buyer can deliver to the CDS protection seller after the auction settlement (each a "deliverable obligation"). Each auction consists of two parts: (1) the first part of the auction, which involves submission of physical settlement requests by participating dealers, aims at determining the initial market mid-point, the net open interests, and adjustment amounts; and (2) the second part of the auction consists of calculating the final settlement price. As noted, protection buyers are incentivized to deliver into the auction the cheapest deliverable obligation, as it maximizes their recovery; as a result, the value of this "cheapest to deliver" deliverable obligation drives the final settlement price. *See* Markit and Creditex Credit Event Auction Primer, 1 (Feb. 2010), available at http://www.creditfixings.com/information/affiliations/fixings/auctions/docs/credit_event_auction_primer.pdf. *See also* Credit Suisse, A Guide to Credit Events and Auctions, 5 (Jan. 11, 2012), available at https://doc.research-andanalytics.csfb.com/docView?language=ENG&source=emfromsendlink&format=PDF&document_id=803733390&serialid=FWHCx3yCrSE3FoEvAbEKa6fRKhqLoKs0jL1gR5W2Dfs%3D.

36 *See* 2010 Rule 9j-1 Proposing Release, 75 FR at 68562. *See also infra* section V.B, discussing broad economic considerations of security-based swaps and specifically TRS.

and could include one payment at the expiration of the TRS or might include a series of payments on periodic interim settlement dates over the tenor of the TRS. For TRS with periodic interim settlement dates counterparties could agree to reset the price of the reference underlying on the periodic interim settlement date based on current market prices of the reference underlying ("reference price"). Accordingly, throughout the life of a TRS, depending on the terms of the TRS, the reference price that determines that payment on periodic interim settlement dates might be reset based on current market prices of the reference underlying.

2. Security-Based Swap Market Developments

In 2010, following the 2008 financial crisis, Congress enacted the Dodd-Frank Act "to promote the financial stability of the United States by improving accountability and transparency in the financial system."[37] Title VII of the Dodd-Frank Act addressed significant issues and risks in the swap and security-based swap markets, which had experienced dramatic growth leading up to the 2008 financial crisis and were shown to be capable of affecting significant sectors of the U.S. economy.[38] In testimony before Congress introducing the first draft of the Dodd-Frank Act, Treasury Secretary Timothy Geithner highlighted the risks posed by an unregulated OTC derivatives market, which had been operating without the "basic protections and oversight" existing in the rest of the financial systems, including a "limited ability to police fraud and manipulation."[39] In his written testimony, Secretary Geithner listed four broad objectives of the proposed reforms which were eventually enacted as Title VII of the Dodd-Frank Act: (1) preventing activities in the OTC derivatives markets from posing risk to the stability of the

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37 Dodd-Frank Act, Pub. L. No. 111-203, Preamble. *See also* Business Conduct Standards Adopting Release, 81 FR at 29961.

38 Business Conduct Standards Adopting Release, 81 FR at 29961. *See also* Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 69490 (May 1, 2013), 78 FR 30967, 30980 (May 23, 2013)("Cross-Border Release") (discussing the spillover and contagion effects arising from security-based swap transactions in the context of American International Group, Inc., and its subsidiary AIG Financial Products Corp.).

39 Senate Hearing on Over the Counter Derivatives Reform and Addressing Systemic Risks, S. Hrg. 1111-803 (Dec. 2, 2009), available at https://www.govinfo.gov/content/pkg/CHRG-111shrg62722/pdf/CHRG-111shrg62722.pdf.

financial system; (2) promoting efficiency and transparency of the OTC derivatives markets; (3) preventing market manipulation, fraud, and other abuses; and (4) protecting consumers and investors by ensuring that OTC derivatives are not marketed inappropriately to unsophisticated parties.[40] Secretary Geithner also stressed that the CFTC and the SEC should be provided with strong authority for civil enforcement and regulation of fraud, market manipulation, and other abuses in the OTC derivative markets.[41] The authority enacted in Title VII of the Dodd-Frank Act includes, but is not limited to, Exchange Act section 9(j). Ensuring that the Commission has the necessary tools to police the security-based swap markets is a key component to ensure that Title VII's reforms are not undermined.

The security-based swap market remains large. Based on information reported pursuant to 17 CFR 242.900 to 242.909 ("Regulation SBSR"), as of November 25, 2022, the gross notional amount outstanding in the security-based swap market is approximately $8.5 trillion across the credit, equity, and interest rate asset classes.[42] The credit security-based swap asset class is large, with a gross notional amount of approximately $4.7 trillion, of which single-name CDS (including corporate and sovereign) account for the largest category at $4.3 trillion.[43] Additionally, as indicated by data submitted pursuant to Regulation SBSR, the size of the equity security-based swap market is also significant – with approximately $3.6 trillion of equity security-based swaps outstanding as of November 25, 2022.[44]

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40 *Id.* (including testimony noting that enacted reforms will result in "very consequential changes" to OTC derivatives markets).

41 *Id.*

42 *See* Report on Security-Based Swaps, Mar. 20, 2023, available at https://www.sec.gov/files/report-security-based-swaps-032023.pdf ("SBS Report"). For further discussion of the Regulation SBSR data, *see infra* section V.C.2.

43 *See id.*

44 *See id.*

In general, the ongoing payments of a security-based swap depend, in part, on its gross notional amount outstanding.[45] The particular aspects and characteristics of security-based swaps (described above in section I.B.1) provide opportunities and incentives for misconduct. In general, parties to a security-based swap may engage in misconduct in connection with the security-based swap (including in the reference underlying of such security-based swap) to trigger, avoid, or affect the value of ongoing payments or deliveries. For instance, a party faced with significant risk exposure may engage or attempt to engage in manipulative or deceptive conduct that increases or decreases the value of payments or cash flow under a security-based swap relative to the value of the reference underlying, including the price or value of a deliverable obligation under a security-based swap. Moreover, fraud and manipulation in connection with a security-based swap can affect not just a direct counterparty, but also counterparties to that counterparty. For example, if fraud or manipulation leads to a large change in variation margin, the defrauded counterparty could default on its obligations to its other counterparties. In addition, other counterparties to the same security-based swaps could be affected by fraud or manipulation that affects the reference underlying assets, as could investors in those underlying assets. Given the global and interconnected nature of the security-based swap markets, it is critical that the Commission has appropriate tools to fight fraud and manipulation in these markets.[46] Recent developments in the security-based swap market highlight these concerns. For example, in the 2021 Proposing Release, the Commission discussed certain

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45 *See, e.g., Bloomberg L.P. v. Commodity Futures Trading Com'n*, 949 F. Supp. 2d 91, 96 (D.D.C. 2013) (stating that a swap "is a contract that typically involves an exchange of one or more payments based on the *underlying value of a notional amount* of one or more commodities, or other financial or economic interest . . . ." (emphasis added)).

46 *See* Application of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities, Exchange Act Release No. 72472 (June 25, 2014), 79 FR 47278, 47283 (Aug. 12, 2014) (discussing the global nature and interconnectedness of the security-based swap market and the potential for risk transmission).

manufactured or other opportunistic CDS strategies that had been reported by academics and the press:[47]

- A CDS buyer working with a reference entity to create an artificial, technical, or temporary failure-to-pay credit event in order to trigger a payment on a CDS to the buyer (and to the detriment of the CDS seller).[48]

- Alone or in combination with the above or other strategies, causing the reference entity to issue a below-market debt instrument in order to artificially increase the auction settlement price for the CDS (*i.e.*, by creating a new "cheapest to deliver" deliverable obligation).[49]

- CDS buyers endeavoring to influence the timing of a credit event in order to ensure a payment (upon the triggering of the CDS) before expiration of a CDS, or a CDS seller taking similar actions to avoid the obligation to pay by ensuring a credit event occurs after the expiration of the CDS, or taking actions to limit or expand the number and/or kind of deliverable obligations in order to impact the recovery rate.[50]

- CDS sellers offering financing to restructure a reference entity in such a way that "orphans" the CDS – eliminating or reducing the likelihood of a credit event by moving the debts off the balance sheets of the reference entity and onto the balance sheets of a subsidiary or an affiliate that is not referenced by the CDS.[51]

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47 2021 Proposing Release, 87 FR at 6655. *See also supra* note 35 and related discussion regarding the operation of CDS auctions.

48 *See* Henry T.C. Hu, Corporate Distress, Credit Default Swaps, and Defaults: Information and Traditional, Contingent, and Empty Creditors, 13 Brook. J. Corp. Fin. & Com. L. 5-32, at 26-27 (Nov. 2018), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3302816.

49 *See* Statement on Manufactured Credit Events by CFTC Divisions of Clearing and Risk, Market Oversight, and Swap Dealer and Intermediary Oversight (Apr. 24, 2018), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/divisionsstatement042418.

50 *See* Hu, *supra* note 48 at 22-26.

51 *See* Gina-Gail S. Fletcher, Engineered Credit Default Swaps: Innovative or Manipulative?, 94 N.Y.U. L. Rev. 1073, 1101 (2019).

- Taking actions, including as part of a larger restructuring, to increase (or decrease) the supply of deliverable obligations by, for example, adding (or removing) a co-borrower to existing debt of a reference entity, thereby increasing (or decreasing) the likelihood of a credit event and the cost of CDS.[52]

The 2021 Proposing Release also discussed the fact that in 2019, the former SEC Chairman issued a joint public statement with the principals of the CFTC and the U.K. Financial Conduct Authority at the time stating that the "continued pursuit of various opportunistic strategies in the credit derivatives markets . . . may adversely affect the integrity, confidence and reputation of the credit derivatives markets, as well as markets more generally."[53]

Taking into consideration all of the above, Rule 9j-1 will be an important additional tool to augment the Commission's oversight of the security-based swap markets including, but not limited to, the markets for CDS and TRS.

B. Overview of the Final Rules

1. Rule 9j-1

As described in detail below, final Rule 9j-1 includes prohibitions on categories of misconduct prohibited by section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and section 17(a) of the Securities Act, when effecting any transaction in, or attempting to effect any transaction in, any security-based swap, or when purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap (including but not limited to, in whole or in part, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, any security based-swap).[54] The final rule also includes a provision prohibiting the

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52 *See* Fletcher, *supra* note 51 at 1098. *See also* CFTC Talks Podcast, Credit Derivatives, (Jul. 10, 2019), available at https://www.cftc.gov/Exit/index.htm?https://youtu.be/Qqo9KR6JXaM?.

53 *See* Joint Statement on Opportunistic Strategies in the Credit Derivatives Market (June 24, 2019), available at https://www.sec.gov/news/press-release/2019-106 ("2019 Joint Statement"); 2021 Proposing Release, 87 FR at 6655.

54 *See* Rules 9j-1(a), (a)(1) through(a)(5), and (d).

manipulation or attempted manipulation of the price or valuation of any security-based swap, including any payment or delivery related thereto. This provision has been moved to paragraph (a)(6) of Rule 9j-1 (from paragraph (b) as proposed) to clarify that these provisions apply to conduct that is undertaken in connection with directly or indirectly effecting, or attempting to effect, any transaction in any security-based swap, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap.[55] Further, final Rule 9j-1 provides that: (1) a person with material nonpublic information about a security cannot avoid liability under the securities laws by communicating about or making purchases or sales in the security-based swap (as opposed to communicating about or purchasing or selling the underlying security); and (2) a person cannot avoid liability under section 9(j) or Rule 9j-1 in connection with a fraudulent scheme involving a security-based swap by instead making purchases or sales in the underlying security (as opposed to purchases or sales in the security-based swap).[56] In addition, final Rule 9j-1 includes two affirmative defenses from the liability under paragraphs (a)(1) through (5) of Rule 9j-1: (1) where the action otherwise prohibited by Rule 9j-1 was taken pursuant to binding rights and obligations in written security-based swap documentation so long as the security-based swap was entered into, or the amendment was made, before the person became aware of the material nonpublic information, and in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 9j-1; and (2) with respect to entities, if the entity demonstrates that the individual at the entity making the investment decision was not aware of material nonpublic information and the entity had implemented reasonable policies and procedures to prevent violations of Rules 9j-1(a)(1) through(5).[57]

2. Rule 15fh-4(c)

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55 *See* Rule 9j-1(a)(6).

56 *See* Rules 9j-1(b) and (c).

57 *See* Rule 9j-1(e).

The Commission also is adopting a rule aimed at protecting the independence and objectivity of an SBS Entity's CCO by preventing the personnel of an SBS Entity from taking actions to coerce, mislead, or otherwise interfere with the CCO. The Commission recognizes that SBS Entities dominate the security-based swap market and also recognizes the important role that CCOs of SBS Entities play in ensuring compliance by SBS Entities and their personnel with the Federal securities laws. As a result, the Commission is adopting Rule 15fh-4©, which makes it unlawful for any officer, director, supervised person, or employee of an SBS Entity, or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the SBS Entity's CCO in the performance of their duties under the Federal securities laws or the rules and regulations thereunder.[58]

II. Rule 9j-1: Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps

Final Rule 9j-1 will aid the Commission in its pursuit of actions that directly target misconduct that reaches security-based swaps. The rule takes into account the features of a security-based swap and the broad definitions of "purchase" and "sale" in the Securities Act,[59] and of "buy," "purchase," "sale," and "sell" in the Exchange Act,[60] to include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security-based swap, as the context may require. Final Rule 9j-1 applies to fraudulent, deceptive, or manipulative misconduct related to the exercise of any right or performance of any obligation under a security-based swap if such misconduct occurs in connection with effecting or attempting to effect a

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58 The Commission also amends the CFR designation of Rule 15Fh-4 in order to ensure the regulatory text conforms more consistently with section 2.13 of the Document Drafting Handbook. *See* Office of the Federal Register, Document Drafting Handbook (Aug. 2018 Edition, Revision 1.4, dated Jan. 7, 2022), available at https://www.archives.gov/files/federal-register/write/handbook/ddh.pdf. In particular, the Commission amends the CFR section designation for 17 CFR 240.15Fh-4 (Rule 15Fh-4) to replace the uppercase letter with the corresponding lowercase letter, such that the rule is redesignated as 17 CFR 240.15fh-4 (Rule 15fh-4).

59 15 U.S.C. 77b(a)(18).

60 15 U.S.C. 78c(a)(13) and (14).

transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, a security-based swap.[61] For example, to the extent that such misconduct results in the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security-based swap, as the context may require, Rule 9j-1 would apply. In adopting Rule 9j-1, the Commission continues to recognize the regulatory and market developments that supported the proposal of an antifraud and anti-manipulation provision.[62]

In general, fraudulent, deceptive, or manipulative conduct, such as providing false or incomplete information to a counterparty to secure better terms or pricing or to alter the performance of ongoing rights and obligations, has the potential to harm counterparties to all forms of security-based swaps, including CDS, equity security-based swaps, and non-CDS debt security-based swaps. Manipulation of the reference underlying security can affect the pricing of an equity or debt security-based swap, as well as the ongoing payments and obligations that are based on the value of that reference security. Further, in some cases, particularly in instances involving security-based swap transactions that are effected over the internet, there is a potential for trading software to distort pricing and payouts on security-based swaps.[63] Finally, to the extent a CDS-related opportunistic strategy alters the operations of a reference entity, shareholders in reference underlying entities and counterparties to any security-based swap based

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61 *See supra* section I.B.1 for a discussion regarding ongoing payments and deliveries that are typical for a security-based swap.

62 *See supra* section I.B.2.

63 *See*, *e.g.*, SEC Investor Alert: Binary Options Fraud, available at https://www.investor.gov/protect-your-investments/fraud/types-fraud/binary-options-fraud ("SEC Binary Options Fraud Alert") (stating that the SEC has received numerous complaints alleging that certain "Internet-based binary options trading platforms manipulate the trading software to distort binary options prices and payouts"). The SEC Binary Options Fraud Alert represents the views of the staff of the Office Investor Education and Advocacy. It is not a rule, regulation, or statement of the Commission. The Commission has neither approved nor disapproved its content. The SEC Binary Options Fraud Alert, like all staff statements, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person. Depending on the facts and circumstances, binary options based on securities may be security-based swaps.

on that reference entity could be impacted; the potential harm is not limited to CDS holders or to the counterparties of bad actors.

A. Misconduct "In Connection With" "Purchases," "Sales," or "Effecting Transactions"

1. Proposed Approach

As proposed, Rule 9j-1 would have prohibited the same categories of misconduct addressed by section 10(b) of the Exchange Act,[64] and Rule 10b-5 thereunder,[65] as well as section 17(a) of the Securities Act.[66] The proposed rule imposed liability for misconduct related to any ongoing payments and deliveries that are typical of security-based swaps and which occur throughout the life of the security-based swap.[67] Specifically, proposed Rule 9j-1(a) would have made it unlawful for any person, directly or indirectly, to purchase or sell, or attempt to induce the purchase or sale of, any security-based swap; to effect any transaction in, or attempt to effect any transaction in, any security-based swap; to take any action to exercise any right, or any action related to performance of any obligation, under any security-based swap, including in connection with any payments, deliveries, rights, or obligations or alterations of any rights thereunder; or to terminate (other than on its scheduled maturity date) or settle any security-based swap, in connection with which such person: (1) employs or attempts to employ any device, scheme, or artifice to defraud or manipulate; (2) makes or attempts to make any untrue statement of a material fact, or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; (3) obtains or attempts 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; or (4) engages

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64 15 U.S.C. 78j(b).

65 17 CFR 240.10b-5.

66 15 U.S.C. 77q(a).

67 *See* 2021 Proposing Release, 87 FR at 6661-62.

or attempts to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[68] Additionally, proposed Rule 9j-1(e) provided that the terms "purchase" and "sale" would have the same meaning as set forth in sections 3(a)(13) and (14) of the Exchange Act.[69]

2. Commission Action

The Commission is adopting final Rule 9j-1(a), but has revised the rule to more closely follow the language used in the definitions of "purchase" and "sale," and "buy" and "sell" in the Exchange Act, as amended by the Dodd-Frank Act, and to respond to commenter concerns.[70] Specifically, the rule makes it unlawful for any person, directly or indirectly, to effect any transaction in, or attempt to effect any transaction in, any security-based swap, or to purchase or sell, or induce or attempt to induce the purchase or sale of, any security-based swap (including but not limited to, in whole or in part, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security based-swap, as the context may require), in connection with which such person engages in the activities specified in Rules 9j-1(a)(1) through (6).[71] Final Rule 9j-1(a) prohibits fraudulent, deceptive, or manipulative misconduct related to the payments, deliveries, rights, or obligations under a security-based swap if that misconduct occurs in connection with effecting or attempting to effect a transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, a security-based swap.[72] Further, the Commission is adopting Rule 9j-1(e) as proposed but now renumbered as final Rule 9j-1(d).

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68 *See* 2021 Proposing Release, 87 FR at 6703.

69 *See* 15 U.S.C. 78c(a)(13) and (14).

70 *See* 15 U.S.C. 78c(a)(13) and (14).

71 *See supra* sections II.B and II.C.

72 *See* final Rule 9j-1(a).

Several commenters supported the application of Rule 9j-1(a) to the exercise of rights and performance of obligations under a security-based swap.[73] One commenter recognized that the proposed rule "appropriately recognizes that [security-based swaps] have unique characteristics in the form of 'ongoing payments or deliveries between the parties throughout the life of the security-based swap pursuant to their rights and obligations,'" which creates additional opportunities for fraud and manipulation, as compared to other types of securities, therefore warranting "their own unique anti-fraud rule."[74]

Two commenters argued that the Commission exceeded its statutory authority by applying proposed Rule 9j-1(a) "to every interim performance obligation" and every exercise of a right under a security-based swap.[75] One commenter asserted that "[h]ad Congress intended" for Exchange Act section 9(j) to cover "actions related to the ongoing performance of obligations under a security-based swap agreement, it would have expressly done so in the Dodd-Frank Act or subsequent legislation, particularly given that it amended the definitions of 'purchase' and 'sale' to reflect security-based swaps."[76] The commenter stated that "[i]n so doing, Congress made a determination to limit the covered actions to 'execution,' 'termination,' 'exchange,' or 'extinguishing' of rights or obligations under a security-based swap."[77] The commenter also stated that "[t]here is also no precedent or support for the Commission to adopt a broad interpretation of the phrase 'to effect any transaction in' . . . as a basis for including interim performance obligations within the scope of proposed Rule 9j-1, as this has not been the

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73 *See* Letter from Andrew Park, Americans for Financial Reform Education Fund ("AFRED"), dated Mar. 21, 2022 ("AFRED Letter"); Letter from Stephen W. Hall and Jason Grimes, Better Markets, Inc., dated Mar. 21, 2022 ("Better Markets Letter"); Letter from Gina-Gail S. Fletcher, Duke University School of Law, dated Mar. 21, 2022 ("Fletcher Letter").

74 Better Markets Letter at 9. Another commenter also noted the "unique risks and long duration, with a potentially complex stream of payments and obligations" of security-based swaps in their support of the scope of the proposed rule. Fletcher Letter at 2.

75 Letter from Jennifer W. Han, Managed Funds Association ("MFA"), dated Mar. 21, 2022 ("MFA Letter"), at 4. *See id*. at 3-8; IIB-ISDA-SIFMA Letter at 6-8.

76 MFA Letter at 5. *See* IIB-ISDA-SIFMA Letter at 6.

77 MFA Letter at 5.

traditional and longstanding understanding of that statutory phrase."[78] Another commenter asserted that the Commission could not use its prophylactic authority under section 9(j) as a means to "extend Proposed Rule 9j-1(a) beyond" what the commenter stated was "any natural reading of the terms 'purchase' or 'sale.'"[79]

The same two commenters also raised practical concerns about applying Rule 9j-1(a) to every exercise of a right or performance of an obligation under a security-based swap. One commenter stated that "if the proposed antifraud rule can be applied to any action or omission '*related to* performance of any obligation,' market participants will undoubtedly seek to limit the scope of their transactions, and the terms of such transactions, in order to mitigate their exposure to liability under the rule" and some market participants would "terminate their involvement in the security-based swap market entirely."[80] The commenter asserted that this result would "reduce liquidity in security-based swap markets and, by restricting hedging opportunities, have a material adverse effect on the availability and cost of capital for issuers."[81] The other commenter asserted that "Proposed Rule 9j-1(a)'s application to non-volitional conduct under [a security-based swap] would not be appropriate because it would cast uncertainty on a wide range of *bona fide* conduct necessary to the operation of the capital markets" and "risks chilling legitimate market conduct as market participants try to determine whether conduct unrelated to an affirmative investment decision could be judged after the fact to be prohibited."[82]

The Commission has carefully considered the comments and, as discussed below in sections II.A.2.a through II.A.2.c, is revising Rule 9j-1 to specify that it applies to misconduct that occurs in connection with effecting any transaction in, or attempting to effect any transaction in, any security-based swap, or purchasing or selling, or inducing or attempting to induce the

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78 *Id.* at 7.

79 IIB-ISDA-SIFMA Letter at 8.

80 MFA Letter at 7-8 (emphasis in original).

81 MFA Letter at 8.

82 IIB-ISDA-SIFMA Letter at 8-9.

purchase or sale of, any security-based swap (including but not limited to, in whole or in part, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security based-swap). The language in final Rule 9j-1(a) is based on section 9(j) of the Exchange Act and the definitions of "purchase" and "sale," and "buy" and "sell," which were amended by the Dodd-Frank Act to take into account the unique characteristics of security-based swaps.[83] The final rule text also is revised to make it unlawful to "induce . . . the purchase or sale" of any security-based swap, in addition to "purchase or sell," and "attempt to induce the purchase or sale of," any security-based swap. This addition is made to track the statutory language of section 9(j) of the Exchange Act.[84] In addition to the changes to Rule 9j-1(a), in response to commenters' practical concerns, as discussed in section II.E.2, the Commission is adopting affirmative defenses.

Depending on the facts and circumstances of a particular situation, as discussed in sections II.A.2.a through II.A.2.c below, final Rule 9j-1 may reach misconduct that affects the payments and deliveries that typically occur throughout the life of a security-based swap, if that misconduct occurs in connection with effecting or attempting to effect any transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap. Consistent with the operation of other antifraud provisions in the securities laws, whether that connection exists will be determined on a case-by-case basis.[85] Sections II.A.2.a

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83 The Dodd-Frank Act amended the definitions of "purchase" and "sale" in section 2(a)(18) of the Securities Act, 15 U.S.C. 77b(a)(18), the definitions of "buy" and "purchase" in section 3(a)(13) of the Exchange Act, 15 U.S.C. 78c(a)(13), and "sale" and "sell" in section 3(a)(14) of the Exchange Act, 15 U.S.C. 78c(a)(14), in the context of security-based swaps, to include "the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require." Final Rule 9j-1(d) makes clear that "[f]or purposes of this section, the terms 'purchase' and 'sale' shall have the same meanings as set forth in Sections 3(a)(13) (15 U.S.C. 78c(a)(13)) and 3(a)(14) (15 U.S.C. 78c(a)(14)) of the Act."

84 *See* 15 U.S.C. 78i(j).

85 One commenter asserted that the Commission's rulemaking authority under section 9(j) is limited to "identify[ing] specific transactions, acts, practices and courses of business" that are fraudulent, deceptive, or manipulative. IIB-ISDA-SIFMA Letter at 8. The text of section 9(j), which authorizes the Commission to "define, and prescribe means reasonably designed to prevent, such transactions, acts, practices, and courses of business as are fraudulent, deceptive, or manipulative," does not require the Commission to identify "specific transactions, acts, practices and courses of business." Because security-based swaps are

through II.A.2.c below discuss the scope of "in connection with," "purchases or sales," and "effecting transactions" in the context of final Rule 9j-1(a).

a. In Connection With

Final Rule 9j-1 prohibits misconduct "in connection with" effecting any transaction in, or attempting to effect any transaction in, any security-based swap, or when purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap. Even if taking an action related to payments and deliveries under any security-based swap would not itself constitute a purchase or sale, or effecting a transaction, conduct that affects payments and deliveries may occur "in connection with" purchases or sales, or effecting a transaction. The Supreme Court has "espoused a broad interpretation" of "in connection with,"[86] holding that the phrase "should be 'construed not technically and restrictively, but flexibly to effectuate its remedial purposes.'"[87] Accordingly, the Court has held that "it is enough that the fraud alleged 'coincide' with a securities transaction."[88] As one commenter who was critical of the breadth of proposed Rule 9j-1(a) acknowledged, "much of the illegitimate conduct described in the [proposing] release" – and in section I.B.2, *supra* – "involves a purchase or sale of securities."[89]

Moreover, the Supreme Court has held that the requirement that "deception occur 'in connection with the purchase or sale of any security'" does not require "deception of an identifiable purchaser or seller" because "[t]he Exchange Act was enacted in part 'to insure the

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complex, and related strategies are constantly evolving, new opportunities for misconduct likewise constantly arise. Rule 9j-1 must be flexible to enable the Commission to prevent such misconduct.

86 *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85 (2006).

87 *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (citations omitted).

88 *Dabit*, 547 U.S. at 85 (citation omitted). *See Superintendent of Ins. of State of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971) ("deceptive practices touching [a] sale" are actionable); *Chadbourne & Parke LLP v. Troice*, 571 U.S. 377, 387 (2014) (fraud occurred "in connection with" a purchase or sale if it was "material to and 'coincided with' third-party securities transactions" (quoting *Dabit*, 547 U.S. at 85)).

89 IIB-ISDA-SIFMA Letter at 9. As an example, the commenter stated, "the credit event under a credit default swap . . . typically settles through an auction process that involves purchases and sales of securities [and] many of the transactions with reference entities identified by the Commission are securities transactions." *Id.* As discussed below, *see infra* section II.A.2.c, settlement also is part of effecting a securities transaction. *See* 15 U.S.C. 78bb(e)(3)(C).

maintenance of fair and honest markets'" generally.[90] The "in connection with" requirement accordingly can be satisfied "even though the person or entity defrauded is not the other party to the trade"—or here, the counterparty to the relevant security-based swap.[91] For that reason, misconduct that affects the payments and deliveries under one security-based swap could be prohibited by final Rule 9j-1 if that misconduct occurs in connection with effecting or attempting to effect transactions or purchasing or selling or attempting to induce the purchase or sale of any security-based swap, and not just the security-based swap that was the subject of the misconduct.

b. Purchases or Sales

Not only is "in connection with" construed broadly, Congress also has broadly defined what constitutes a "purchase" and "sale." Generally, purchases and sales of securities include "contracts to buy, purchase or otherwise acquire" or "contracts to sell or otherwise dispose of" the security, respectively.[92] For security-based swaps, as part of the provisions of the Dodd Frank Act that gave the Commission new authority over that market, Congress added that purchases and sales also include "the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require."[93] Final Rule 9j-1(a) accordingly prohibits fraudulent, deceptive, or manipulative conduct that affects ongoing payments and deliveries under a security-based swap if that misconduct occurs in connection with any activity that falls within those broad definitions.[94]

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90 *United States v. O'Hagan*, 521 U.S. 642, 657-58 (1997) (quoting 15 U.S.C. 78b).

91 *Id*. at 656.

92 15 U.S.C. 78c(a)(13) and 78c(a)(14).

93 15 U.S.C. 77b(a)(18), 78c(a)(13), and 78c(a)(14).

94 One commenter expressed concern that the term "terminate (other than on its scheduled maturity date)" in proposed Rule 9j-1(a) was "simultaneously too broad and too narrow." Fletcher Letter at 2. The commenter stated that the term "would appear to exempt terminations at maturity from the scope of the rule" even if "an opportunistic scheme could be executed in line with the scheduled maturity date," while applying to "contractually permitted terminations" prior to maturity that are "not conducted to intentionally distort the swap transaction." *Id*. Consistent with Exchange Act sections 3(a)(13) and (14), the Commission has revised final Rule 9j-1(a) to state that a purchase or sale of a security-based swap includes, but is not limited to, a "termination (prior to its scheduled maturity date) . . . of . . . a security-based swap," and

Those definitions are not limited to executions, terminations, assignments, exchanges, or similar transfer or conveyance of, or extinguishing of *all* the rights or obligations under, a security-based swap. Therefore, the Commission also has revised final Rule 9j-1(a) to add the words "including but not limited to, in whole or in part" before listing the activities enumerated in Exchange Act sections 3(a)(13) and (14).[95] In addition, the final rule includes the word "any" before "rights or obligations." These modifications clarify that, for purposes of the antifraud and anti-manipulation provisions of paragraph (a), the definitions of purchase and sale encompass, among other things, *partial* executions, terminations, assignments, exchanges, transfers or conveyances of, or extinguishing of *any* rights or obligations under, a security-based swap, as the context may require.[96] The Commission stated in the 2021 Proposing Release that the Exchange Act's definitions of purchase and sale in the context of security-based swaps "incorporate actions that have an impact on some, but not all, rights and obligations" under a security-based swap, including "partial executions, terminations, assignments, exchanges, transfers, or extinguishments of rights or obligations."[97] Commenters did not disagree.[98]

It also is reasonable to include partial executions, terminations, assignments, exchanges, or similar transfers or conveyances of, or extinguishing of rights or obligations under, a security-based swap within the scope of the rule because those actions could result in amendments to the

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includes any "similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security-based swap, as the context may require." Depending on the context, the termination of a security-based swap on the scheduled maturity date could constitute such a "similar transfer or conveyance" or "extinguish[ment] of any rights or obligations." And while a contractually permitted termination of a security-based swap prior to maturity constitutes a purchase or sale under the terms of both section 3(a) and Rule 9j-1(a), Rule 9j-1(a) prohibits only fraudulent, deceptive, or manipulative conduct in connection with a termination.

95 The phrase "but not limited to" reflects the fact that Exchange Act sections 3(a)(13) and (14) do not limit the definition of purchase or sale to the enumerated activities, contrary to the assertion of one commenter. *See* MFA Letter at 5; *supra* notes 76 and 77, and related discussion.

96 *See* Rule 9j-1(a) ("to purchase or sell, or induce or attempt to induce the purchase or sale of, any security-based swap (including but not limited to, in whole or *in part*, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of *any* rights or obligations under, a security based-swap, as the context may require").

97 2021 Proposing Release, 87 FR at 6661.

98 *See, e.g.*, IIB-ISDA-SIFMA Letter at 7 ("We concur with this reading, insofar as it would extend Proposed Rule 9j-1(a) to an affirmative action relating to an investment decision and affecting a material term of [a security-based swap], for example a partial termination or assignment.").

material terms of the security-based swap and, therefore, result in a new security-based swap (that is, a "purchase" or "sale").[99] Security-based swaps take many different forms and are used for many different purposes, but often are used to hedge risks. Even a partial change in any of the rights and obligations underlying the security-based swap—particularly those related to ongoing payments and deliveries—could affect the alignment of that hedge with the attendant risk and, under a facts and circumstances analysis, could constitute a purchase or sale of a security-based swap. A different approach – one that only prohibited misconduct in connection with the extinguishment of all of the rights and obligations under a security-based swap – would leave market participants vulnerable to the risks that the security-based swap was entered into to address (as well as decrease the alignment of any hedge entered into to address the risk of the security-based swap itself). These revisions to the text of final Rule 9j-1 also ensure that market participants cannot evade liability under Rule 9j-1 by, for example, structuring fraudulent, deceptive, or manipulative conduct so that some portion of a counterparty's rights and obligations under a security-based swap remain in place.

Relatedly, the Commission reiterates that "[i]f the material terms of a" security-based swap "are amended or modified during its life based on an exercise of discretion and not through predetermined criteria or a predetermined self-executing formula," then "the amended or modified" security-based swap is a "new" security-based swap.[100] For example, contrary to one

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99 *See infra* note 100, and related discussion of amendments of material terms.

100 Product Definitions Release, 77 FR at 48286; *see* 17 CFR 230.145(a) Preliminary Note ("Changing the nature and terms of an investor's relationship to the issuer may represent the offer or sale of a new security for value."); 2021 Proposing Release, 87 FR at 6661. Similarly, courts have found that if an amendment or modification to the terms of a security results in "'a significant change in the nature of the investment or risk'" related to that security, a new security results. *Department of Economic Development v. Arthur Anderson & Co. (U.S.A.)*, 924 F. Supp. 449, 478 (S.D.N.Y. 1996) (citation omitted). *See also, e.g.*, *Ingenito v. Bermac Corp.*, 376 F. Supp. 1154, 1181 (S.D.N.Y. 1974) (considering claims of Section 10(b) and finding that "a purchase or a sale arises when the nature and terms of an investor's involvement in a business enterprise are substantially altered by the creation of new rights or obligations"); Louis Loss, et al., Securities Regulation § 3.A.2 (2023) (citing to *N. Natural Gas Co.*, 14 SEC 506, 509 (1943) (noting that "for example, a change in interest or dividend rate or a liquidation preference or underlying security, or a change in the identity of the issuer, would seem clearly to result in a new security")). Changes are more likely to be considered "significant" if they are adverse to the security holders affected. *See, e.g., SEC v. Associated Gas & Electric Co*., 99 F.2d 795, 797-98 (2nd Cir. 1938) (holding that under the Public Utility Holding Company Act of 1935, the extension of the maturity date of a debt security increased the risk to

commenter's assertion,[101] amendments to terms regarding ongoing rights and obligations under a security-based swap, including those related to ongoing payments and deliveries, could result in a new transaction.[102] When an amendment or modification constitutes a purchase or sale of a security-based swap, Rule 9j-1(a) prohibits any fraudulent, deceptive, or manipulative conduct that occurs in connection with it.

Two commenters agreed that "Rule 9j-1 should be applicable . . . if the parties to a security-based swap transaction make changes to material terms that result in the creation of a new transaction."[103] But these commenters disagreed with the Commission's assertion in the 2021 Proposing Release that such a modification or amendment—and thus a purchase or sale—occurs when a party engages in conduct that "has a material impact on any payment or delivery under the security-based swap, such that it would not be consistent with what a reasonable person would have expected to pay, deliver, or receive absent such conduct."[104] Under final Rule 9j-1(a), whether a purchase or sale of a security-based swap has occurred will depend on the facts and circumstances and therefore the operation of the rule, as revised, is not dependent on the language in the 2021 Proposing Release quoted by the commenters.[105] Applying a facts and

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the holder and therefore constituted the sale of a new security). *See also Rathborne v. Rathborne*, 683 F.2d 914, 920 (5th Cir. 1982) ("In determining whether a party to a securities transaction is a 'purchaser' or 'seller,' we must ask whether the transaction has wrought a fundamental change in the nature of the plaintiff's investment. . . . [T]he core issue is whether the transaction has transformed the plaintiff into the functional equivalent of a purchaser or seller—has the plaintiff been forced to exchange his stock for shares representing a participation in a substantially different enterprise? We must focus upon the economic reality of the transaction, and determine whether the transaction has 'transformed' the plaintiff's interests 'in any real sense.'" (citations omitted)); *Keys v. Wolfe*, 709 F.2d 413, 417 (5th Cir. 1983) (holding that "the determination of whether" there has been "a significant change in the nature of the investment or in the investment risks . . . hinges on the economic reality of the transaction rather than on formal changes in the rights and obligations of the parties").

101 MFA Letter at 6.

102 *See* Loss, *supra* note 100 (noting that "a change in interest or dividend rate"—which is an ongoing right or obligation—"would seem clearly to result in a new security").

103 MFA Letter at 4. *See* IIB-ISDA-SIFMA Letter at 7 ("[M]arket participants have arranged their affairs to treat such an exercise of discretion to amend a material term of [a security-based swap] as tantamount to the 'purchase' or 'sale' of [a security-based swap], including for anti-fraud purposes.").

104 2021 Proposing Release, 87 FR at 6661. *See* IIB-ISDA-SIFMA Letter at 7-8; MFA Letter at 4.

105 *See supra* note 96. The language "as the context may require," which is included in Rule 9j-1, comes from the definitions of purchase and sale in Exchange Act sections 3(a)(13) and 3(a)(14), and recognizes the need to consider the facts of a particular situation to determine whether a purchase or sale has occurred.

circumstances analysis, if conduct that affects ongoing payments or deliveries results in the extinguishment of a right or obligation under a security-based swap, such as the right to such a payment or delivery, or otherwise results in a new transaction, then a purchase or sale will have occurred, and any related fraudulent, deceptive, or manipulative misconduct will fall within Rule 9j-1's prohibitions.

c. Effecting Transactions

Exchange Act section 9(j), and accordingly final Rule 9j-1(a), also is not limited to prohibitions on fraud, manipulation, or deception in connection with the purchase or sale of a security-based swap, but also encompasses misconduct in connection with effecting a transaction in any security-based swap. While the term "transaction" "is not defined in the Act, its broad meaning in everyday usage" and "the context in which it is used in the various sections of the Act" demonstrate that "it has a broader meaning than purchases or sales."[106] The Commission accordingly has construed the term "to effect any transaction in" a security, variations of which appear in numerous provisions of the securities laws, to include activity such as placing bids or orders, and clearance and settlement of a securities transaction.[107] The Commission also has stated that "key aspects of the overall process of effecting security-based swap transactions" include "sales, booking and cash and collateral management activities."[108]

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106 *In re Kidder Peabody & Co.*, 18 S.E.C. 559, 1945 WL 332559, at *8 (Apr. 2, 1945) (interpreting Exchange Act section 9(a)(2) and finding that Congress intended to extend its "prohibition against manipulation . . . beyond the actual consummation of purchases or sales," to include "affecting the market artificially by raising or depressing security prices, or creating actual or apparent activity, whether or not accomplished by actual purchases or sales"). *See SEC v. Lek Sec. Corp.*, 276 F. Supp. 3d 49, 62 (S.D.N.Y. 2017) ("Courts have held that a 'series of transactions' includes not only completed purchases or sales but also bids and orders to purchase or sell securities.").

107 *Kidder Peabody*, 1945 WL 332559, at *8. *See* 15 U.S.C. 78bb (identifying "clearance, settlement, and custody" as "functions incidental" to "effect[ing] securities transactions"). Settlement of security-based swaps occurs over time in accordance with contractually agreed upon terms (in contrast to other securities such as debt or equity, where settlement occurs when the parties exchange securities for cash equal to the full value of the securities sold). *See* T+1 Adopting Release, 88 FR at 13878, 13883 (quoting SIFMA who noted that, that for security-based swaps, settlement occurs when a "final net payment is paid by one party to the other at a future point in time to which the parties have contractually agreed'' (citation omitted)). *See also supra* note 32.

108 Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 75611 (Aug. 5, 2015), 80 FR 48964, 48976 n.99 (Aug. 14, 2015) ("SBSD/MSBSP Registration Process Release"). In the SBSD/MSBSP Registration Process Release, in the

Final Rule 9j-1(a) therefore prohibits fraudulent, manipulative, or deceptive conduct related to the exercise of rights or performance of obligations—including ongoing payments and deliveries—under a security-based swap if that misconduct occurs in connection with a broad range of activities "beyond the actual consummation of purchases or sales."[109] For example, as discussed in section II.C below, a manipulation of the ongoing payments and deliveries under a security-based swap could be used to "affect[] the market artificially by raising or depressing securities prices," and that conduct would be connected to effecting transactions in security-based swaps.[110] Similarly, as one commenter noted, a "misappropriation of customer margin" would be connected to effecting a security-based swap transaction.[111]

In addition, the Commission is extending the application of final Rule 9j-1(a) to fraudulent, deceptive, or manipulative misconduct that occurs in connection with an "attempt" to effect a transaction in any security-based swap. This application is consistent with section 9(j)'s prohibition of fraud, deception, and manipulation in connection with an "attempt to induce the purchase or sale of" any security-based swap and is supported by case law that recognizes that

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context of determining who has to register as a security-based swap dealer, the Commission identified some activities that would fall within the definition of "involved in effecting security-based swap transactions" – for example, pricing security-based swap positions and managing collateral. The identification of these activities as part of "the overall process of effecting" a transaction" also serves to demonstrate that not all activities in that process take place prior to the execution of the security-based swap. *See* MFA Letter at 7 (asserting "[i]nterpretations of 'effect[ing] a transaction,' . . . have been limited to the process *leading to* the purchase or sale of a security" (emphasis added)). In addition, as the Commission has previously explained in the context of broker-dealers, "effecting" transactions in securities has been construed broadly to encompass a wide range of activities, including: (1) transmission of an order for execution, order execution, clearance and settlement, and arranging for the performance of any such function, *see* 17 CFR 240.11a2-2(T); 2014 Temp Rule 11a2-2(T); and (2) screening potential transaction participants for creditworthiness, soliciting securities transactions, routing or matching orders or facilitating the execution of a transaction, handling customer funds and securities, and preparing and sending transaction confirmations, Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, Exchange Act Release No. 44291 (May 11, 2001), 66 FR 27760, 27772-73 (May 18, 2001)). Critically, several of these activities are not limited to pre-trade actions (e.g., clearance, settlement, and handling counterparty funds).

109 *Kidder Peabody*, 1945 WL 332559, at *8. *See* 15 U.S.C. 78bb (identifying "clearance, settlement, and custody" as "functions incidental" to "effect[ing] securities transactions").

110 *Id*. For example, a platform that effects transactions in security-based swaps, such as binary options or other event contracts, could fraudulently extinguish a holder's right to payment. Such conduct could also affect the market price for similar binary options or event contracts.

111 IIB-ISDA-SIFMA Letter at 9.

fraudulent, deceptive, or manipulative conduct need not be successful to violate the securities laws.[112] It is also a "means reasonably designed to prevent" misconduct that results in completed transactions, which the statute explicitly prohibits.[113]

B. Fraudulent, Manipulative, or Deceptive Conduct

1. Proposed Approach

Proposed Rules 9j-1(a)(1) through (4), describing the prohibited fraudulent, manipulative, or deceptive conduct, was structured to include the antifraud and anti-manipulation provisions – in section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and section 17(a) of the Securities Act – that apply to *all* securities (including security-based swaps), and the additional antifraud and anti-manipulative authority specific to security-based swaps provided to the Commission in section 9(j) of the Exchange Act. Specifically, the proposed rule would have prohibited: (1) employing or attempting to employ any device, scheme, or artifice to defraud or manipulate; (2) making or attempting to make any untrue statement of a material fact, or omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; (3) obtaining or attempting 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; or (4) engaging or attempting to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any

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112 *See, e.g.*, *Koch v. SEC*, 793 F.3d 147, 153–54 (D.C. Cir. 2015) ("[I]ntent—not success—is all that must accompany manipulative conduct to prove a violation of the Exchange Act and its implementing regulations." (citation omitted)); *Kuehnert v. Texstar Corp.*, 412 F.2d 700, 704 (5th Cir. 1969) ("[W]e are not convinced of any difference in substance between a successful fraud and an attempt. The statutory phrase 'any manipulative or deceptive device,' 15 U.S.C. § 78j(b), seems broad enough to encompass conduct irrespective of its outcome."); *Lek*, 276 F. Supp. at 60 (S.D.N.Y. 2017) ("manipulative conduct need [not] be successful in order to violate the securities laws"); *SEC v. Martino*, 255 F. Supp. 2d 268, 287 (S.D.N.Y. 2003) ("an attempted manipulation is as actionable as a successful one"). *See also Lorenzo v. SEC*, 139 S. Ct. 1094, 1104 (2019) ("The Commission . . . need not show reliance in its enforcement actions.").

113 15 U.S.C. 78i(j).

person.[114]

Proposed Rules 9j-1(a)(1) and (2), consistent with section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and section 17(a)(1) of the Securities Act, would have required scienter. In contrast, proposed Rules 9j-1(a)(3) and (4) would not have required scienter and would have extended to conduct that is at least negligent, consistent with sections 17(a)(2) and (3) of the Securities Act.

2. Commission Action

After considering the comments, the Commission is revising proposed Rule 9j-1(a) as discussed below in sections II.B.2.a and II.B.2.b.[115]

Final Rule 9j-1(a)(1) is being adopted as proposed, and will prohibit employing or attempting to employ any device, scheme, or artifice to defraud or manipulate. Although most of that language is derived from section 10(b) of the Exchange Act,[116] Rule 10b-5 thereunder,[117] and section 17(a)(1) of the Securities Act,[118] the inclusion of "manipulate" also comes from the text of section 9(j)).

Final Rule 9j-1(a)(2), which is based on section 9(j) and Rule 10b-5, will prohibit making or attempting to make any untrue statement of a material fact, or omitting to state a material fact

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114 2021 Proposing Release, 87 FR at 6658-60.

115 Final Rule 9j-1(a)(6), which is a revision of proposed Rule 9j-1(b), is discussed in section II.C below.

116 Section 10(b) of the Exchange Act provides that "[i]t shall be unlawful for any person, directly or indirectly . . . (b) to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. 78j(b).

117 Rule 10b-5 under the Exchange Act provides that "[i]t shall be unlawful for any person, directly or indirectly . . . (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 CFR 240.10b-5.

118 Section 17(a) of the Securities Act provides that "[i]t shall be unlawful for any person in the offer or sale of securities . . . directly or indirectly—(1) to employ any device, scheme, or artifice to defraud, or (2) 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 are made, not misleading, or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser." 15 U.S.C. 77q(a).

necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

Proposed paragraphs (a)(3) and (4) are revised to separate attempted conduct into a new paragraph (a)(5) (to which a scienter standard is applicable, as discussed in section II.B.2.b below). Paragraph (a)(3) will prohibit obtaining 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 (a)(4) will prohibit engaging in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. Paragraphs (a)(3) and (4) are based on sections 17(a)(2) and (3) of the Securities Act, as well as Exchange Act section 9(j), which similarly prohibits "engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any person."[119]

Paragraph (a)(5) will prohibit attempting 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 or attempts to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. As discussed in section II.B.2.b below, the prohibition on attempted conduct in paragraphs (a)(1), (a)(2), and (a)(5) is premised on the text of section 9(j), including the Commission's prophylactic authority to "prescribe means reasonably designed to prevent, such transactions, acts, practices, and courses of business as are fraudulent, deceptive, or manipulative, and such quotations as are fictitious."

The provisions described above generally prohibit a range of fraudulent, manipulative, and deceptive conduct in the security-based swap market.[120] Case law related to section 10(b) of

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119 *See supra* notes 5 and 118.

120 *See* 2021 Proposing Release, 87 FR at 6659.

the Exchange Act, Rule 10b-5 thereunder, and section 17(a) of the Securities Act provides guidance as to what conduct violates section 9(j) of the Exchange Act and Rule 9j-1 thereunder.

a. Scienter and Negligence Standards

Findings of misconduct under final Rules 9j-1(a)(1) and (2) require scienter while final Rules 9j-1(a)(3) and (4) do not require scienter and extend to conduct that is at least negligent.[121] While both Rules 9j-1(a)(2) and (3) prohibit material misstatements and omissions,[122] they address different levels of culpability.[123] Specifically, Rule 9j-1(a)(2) will apply when there is evidence of scienter (*e.g.*, when a party to a security-based swap knowingly or recklessly makes a false statement even though the party may not receive any money or property as a result). In contrast, Rule 9j-1(a)(3) extends to conduct that is at least negligent (*e.g.*, when a party to a security-based swap knows or reasonably should know that a statement was false or misleading and directly or indirectly obtains money or property by means of such statement).

Several commenters argued for a scienter standard, rather than the proposed negligence standard, with respect to paragraphs (3) and (4) of Rule 9j-1(a).[124] Specifically, one commenter

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121 In addition, findings of misconduct under paragraphs (a)(5) and (a)(6) will require scienter. *See infra* section II.B.2.b (paragraph (a)(5)) and section II.C.2 (paragraph (a)(6)).

122 Consistent with section 10(b) of the Exchange Act, such misstatements and omissions must be material to be actionable. "The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor . . . there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 445, 449 (1976). *See also Basic v. Levinson*, 485 U.S. 224, 233 (1988).

123 In addition to differences in the standard, there are additional deviations between Rules 9j-1(a)(2) and (3), notwithstanding the significant overlap in the rule text. For example, while paragraph (a)(2), like Rule 10b-5(b), makes it unlawful to make any untrue statement of a material fact, paragraph (a)(3), like section 17(a)(2) of the Securities Act does not use the word "make." Based on that difference courts have contrasted the application of Rule 10b-5(b) from the application of section 17(a)(2) of the Securities Act as it relates to determining who is the maker of a material misstatement. *See*, *e.g.*, *SEC v. Big Apple Consulting USA, Inc.*, 783 F.3d 786, 797 (11th Cir. 2015) ("[W]e . . . agree with the Securities and Exchange Commission's recent opinion, which held '*Janus's* limitation on primary liability under Rule 10b-5(b) does not apply to claims arising under Section 17(a)(2).'"); *SEC v. Tambone*, 597 F.3d 436, 444 (1st Cir. 2010) (en banc) (contrasting the language of Rule 10b-5(b) with "the expansive language of section 17(a)(2)," which covers "the 'use' of an untrue statement of material fact (regardless of who created or composed the statement)").

124 *See* IIB-ISDA-SIFMA Letter at 13 (arguing against applying a negligence standard for attempted conduct); LSTA Letter, at 5-7; MFA Letter at 12; Letter from John R. Williams, Milbank LLP, dated Mar. 22, 2022 ("Milbank Letter"), at 5. The European Banking Federation ("EBF") supports the arguments in the IIB-ISDA-SIFMA Letter regarding proposed Rule 9j-1. *See* Letter from EBF, dated Apr. 1, 2022, at 1. As proposed, paragraphs (3) and (4) of Rule 9j-1(a) would have prohibited actions related to security-based

argued that applying a negligence standard "is inconsistent with the concept of fraud" and that "mere human error – which often occurs from the high volume of the [security-based swaps] business/frequent settlement activities – could result in liability."[125] Another commenter stated that, at a minimum, "any liability for interim actions taken during the term of the security-based swap should be subject to a scienter standard."[126] In addition, other commenters believed that a negligence based standard would be "disruptive to" or "chill" the security-based swap market[127] and interfere with the legitimate actions taken by lenders engaged in security-based swap transactions.[128]

Although the Commission has considered the concerns raised by these commenters, it is adopting Rules 9j-1(a)(1) through (4) using the same standards as proposed, with the exception of the attempted misconduct addressed in paragraph (a)(5), as discussed below. Each of these four provisions is based on an existing statutory and regulatory provision that is supported by a large body of case law. Final Rules 9j-1(a)(1) and (2), consistent with section 10(b) of the

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swaps in which a person obtains or attempts 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, or in which a person engages or attempts to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

125 *See* Milbank Letter at 5.

126 MFA Letter at 12-13 (arguing that liability under Rule 9j-1(a)(3) and (4) should be subject to scienter because security-based swap transactions are between "sophisticated counterparties dealing directly with each other on negotiated terms" rather than "impersonal transactions" where there is a stronger argument for imposing liability under section 17(a) without scienter because it is harder to form a specific intent absent a relationship between the purchaser and the seller). Actions by the Commission demonstrate that security-based swap transactions are not always between sophisticated counterparties with ongoing relationships. *See*, *e.g.*, *In the Matter of Plutus Financial Inc. d/b/a Abra and Plutus Technologies Philippines Corp.*, Exchange Act Release No. 89296 (July 13, 2020) (offering security-based swaps to retail investors via a phone application); *In the Matter of Forcerank LLC*, Exchange Act Release No. 79093 (Oct. 13, 2016) (illegally offering complex security-based swaps to retail investors). *See also* SEC Binary Options Fraud Alert, *supra* note 63 (alerting investors of fraudulent binary options internet-based trading platforms).

127 *See*, *e.g.*, MFA Letter at 12; Milbank Letter at 5. *See also* ACLI Letter at 6 (arguing that "a negligence standard . . . could impact detrimentally other market participants that are involved in private credit markets and originations").

128 *See* LSTA Letter at 5-6 (supporting a scienter standard to "address the concern that a lender could be subject to negligence claims as a result of the often-fluid nature of security-based swap or loan transactions that may be subject to private negotiations, restructuring, or amendment at any given time").

Exchange Act, and Rule 10b-5 thereunder,[129] and section 17(a)(1) of the Securities Act,[130] require scienter. In contrast, final Rules 9j-1(a)(3) and (4) do not require scienter and extend to conduct that is at least negligent, consistent with sections 17(a)(2) and (3) of the Securities Act.[131]

Although, as noted above, certain commenters argued that a negligence standard would be inconsistent with a fraud rule,[132] the Supreme Court has determined that a negligence standard applies to the fraud rule upon which the provisions in Rules 9j-1(a)(3) and (4) are based –

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129 To state a claim under section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, the Commission must establish that the misstatements or omissions were made with scienter. *See*, *e.g.*, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). The Supreme Court has defined scienter as "a mental state embracing intent to deceive, manipulate or defraud." *Id.* Recklessness will generally satisfy the scienter requirement. *See*, *e.g.*, *Sunstrand Corp. v. Sun Chemical Corp.,* 553 F.2d 1033, 1045 (7th Cir. 1977). *See also Greebel v. FTP Software, Inc.*, 194 F.3d 185, 198 (1st Cir. 1999); *SEC v. Environmental, Inc.*, 155 F.3d 107, 111 (2d Cir. 1998).

130 Establishing violations of Securities Act section 17(a)(1) requires a showing of scienter. *See*, *e.g.*, *Aaron v. SEC*, 446 U.S. 680, 701-02 (1980). Scienter is the "mental state embracing intent to deceive, manipulate or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). *See also* section 206(1) of the Investment Advisers Act of 1940 ("Advisers Act"), which makes it unlawful for an investment adviser to employ any device, scheme, or artifice to defraud any client or prospective client. 15 U.S.C. 80b-6(1). Claims arising under section 206(1) of the Advisers Act require scienter. *See*, *e.g.*, *Robare Grp. LTD v. SEC*, 922 F.3d 468, 472 (D.C. Cir. 2019); *SEC v. Moran*, 922 F. Supp. 867, 896 (S.D.N.Y. 1996); *Carroll v. Bear, Stearns & Co.*, 416 F. Supp. 998, 1001 (S.D.N.Y. 1976).

131 Actions pursuant to sections 17(a)(2) and 17(a)(3) of the Securities Act do not require a showing of scienter. *See*, *e.g.*, *Aaron*, 446 U.S. at 701-02. In *Aaron*, the Supreme Court sought to determine whether scienter was required in a Commission injunctive proceeding pursuant to the antifraud provisions of section 10(b) of the Exchange Act and section 17(a) of the Securities Act. The Court examined the language of both sections and determined that scienter was required under section 10(b) because the words "manipulative," "device," and "contrivance," which are used in the statute, evidenced a Congressional intent to proscribe only knowing or intentional misconduct. Similarly, the Court concluded that subsection (1) of section 17(a) required proof of scienter because Congress used such words as "device," "scheme," and "artifice to defraud." *Aaron*, 446 U.S. at 696. In contrast, the Court concluded that the absence of such words under subsections (2) and (3) of section 17(a) demonstrated that no scienter was required. Section 17(a)(2) prohibits any person from obtaining money or property "by means of any untrue statement of a material fact or omission to state a material fact," which the Court found to be "devoid of any suggestion whatsoever of a scienter requirement." *Aaron*, 446 U.S. at 696. Similarly, the Court found, in construing section 17(a)(3), under which it is unlawful for any person "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit," that scienter was not required because it "quite plainly focuses upon the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible." *Aaron*, 446 U.S. at 697.

132 *See* MFA Letter at 12 (arguing that a negligence standard could extend liability "to conduct that is merely negligent or inadvertent, without requiring any intent by the party to mislead or defraud"); Milbank Letter at 5 (arguing in addition that the negligence standard is inconsistent with the concept of fraud which requires intent or recklessness and that human error could result in liability). Courts have found, for example, that the negligence standard in 17(a) requires a defendant to act in the manner that a reasonably prudent person in its position would have acted under the circumstances. *SEC v. Shanahan*, 646 F.3d 536, 545-46 (8th Cir. 2011).

Securities Act sections 17(a)(2) and (3).[133] In *Aaron v. SEC*, the Supreme Court stated that violations of these provisions could be satisfied by a finding of a mental state lower than scienter.[134] Specifically, the Court determined that the "language of [section] 17 (a)(2), which prohibits any person from obtaining money or property 'by means of any untrue statement of a material fact or any omission to state a material fact,' is devoid of any suggestion whatsoever of a scienter requirement"[135] and "the language of [section] 17 (a)(3), under which it is unlawful for any person 'to engage in any transaction, practice, or course of business which *operates* or *would operate* as a fraud or deceit,' (emphasis added) quite plainly focuses upon the *effect* of particular conduct on members of the investing public, rather than upon the culpability of the person responsible."[136] It would be incongruous to provide different standards in Rules 9j-1(a)(3) and (4), which use language identical to the language in sections 17(a)(2) and (3) of the Securities Act that was interpreted by the Supreme Court.

In addition, the Commission disagrees with commenters who argued that scienter must apply because of the ongoing and "fluid nature" of security-based swap transactions.[137] The

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133 Moreover, these provisions are consistent with the antifraud and anti-manipulation authority that the Commission had under the Commodity Futures Modernization Act over security-based swap agreements as then defined in section 206B of the Gramm-Leach-Bliley Act. Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, section 1(a)(5), 114 Stat. 2763 (Dec. 21, 2000) (codified at 15 U.S.C. 78j(b)). Prior to the passage of the Dodd-Frank Act, section 206B of the Gramm-Leach-Bliley Act defined a "security-based swap agreement" as a "swap agreement . . . of which a material term is based on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein." Gramm-Leach-Bliley Act, Pub. L. No. 106-102 section 206B, 113 Stat 1338 (Nov. 12, 1999) (set out as a note under 15 U.S.C. 78c). Given that many security-based swaps would have been security-based swap agreements before the passage of the Dodd-Frank Act, it is contrary to the purposes of the Dodd-Frank Act to create a scienter standard under Rule 9j-1 for actions that would have been covered by a negligence standard under section 17(a) of the Securities Act pre-Dodd-Frank.

134 *See Aaron*, 446 U.S. at 696-97 (discussing the standard under sections 17(a)(2) and (3) of the Securities Act).

135 *Id.* at 696.

136 *Id.* at 696-97.

137 *See*, *e.g.*, LSTA Letter at 6 (arguing that a scienter standard would address concerns that a lender would be subject to negligence claims as a result of the "fluid nature" of security-based swap or loan transactions that may be subject to private negotiations, restructuring, or amendment at any given time); MFA Letter at 12-13 (arguing that sections 17(a)(2) and (3) of the Securities Act apply only to purchases or sales of securities and not to the performance of interim obligations, and also to impersonal transactions with no relationship between parties, all of which suit a negligence standard as compared to security-based swap transactions). Commenters were also concerned that a negligence standard would chill or be disruptive to the market. *See* MFA Letter at 13.

Commission agrees, as stated previously, that a fundamental aspect of a security-based swap is the ongoing payments or deliveries between the parties through the life of the security-based swap. That characteristic creates additional opportunities for misconduct after the parties enter into the security-based swap contract and during the term of the security-based swap.[138] The Commission disagrees, however, that the nature of security-based swaps – and the additional opportunities for harm – warrants applying a scienter standard rather than following the precedent applicable to sections 17(a)(2) and (3) of the Securities Act. Following the Court's ruling in *Aaron v. SEC*, Rules 9j-1(a)(3) and (4) focus on the "effect" of the particular misconduct, and therefore, a negligence standard is appropriate.

Similarly, the Commission does not agree with the commenters who suggested that the sophistication of, or the extent of the relationship between, counterparties to a security-based swap negates the need to prohibit certain misconduct, such as the acquisition of money or property by means of an untrue statement or acts that operate as a fraud, absent a showing of scienter, as provided in Rules 9j-1(a)(3) and (4).[139] Although the courts and Commission have, for example, recognized that certain investors, based on qualities such as wealth or asset size,[140] do not always need the same disclosure and similar investor protections as retail investors because they can "fend for themselves,"[141] the Commission and courts have also stated that sophisticated investors are entitled to protections of the general antifraud or anti-manipulation

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138 *See supra* section I.B.

139 *See, e.g.*, MFA Letter at 13 (arguing that the sophistication of and personal relationships of counterparties to security-based swap transactions supported a scienter standard).

140 *See* 17 CFR 230.500 *et seq.* ("Reg D") (providing an exemption from registration under section 5 of the Securities Act for securities offered or sold by an issuer to accredited investors). *See also* 17 CFR 230.501(a) (defining accredited investors to include, among other things, organizations with assets in access of $5,000,000 and natural persons with a net worth in excess of $1,000,000).

141 *See, e.g., SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953) (indicating that the application of the nonpublic offering exemption under Securities Act section 4(a)(2) (at the time, section 4(1)) depended on whether the offerees were able to fend for themselves and had access to the same kind of information that would be disclosed in registration). The Court noted that such persons, by virtue of their knowledge, would not need to rely on the protections afforded by registration.

provisions of the Federal securities laws.[142] Nothing in section 9(j) suggests that it should only apply to a limited subset of market participants.

To the extent that there is overlap between Rules 9j-1(a)(3) and (4) and sections 17(a)(2) and (3) of the Securities Act, introducing a different standard would be counter to the position the Supreme Court took with regard to identical language used in section 17(a) of the Securities Act.[143] A different standard could also potentially undermine the effectiveness of both provisions in certain circumstances, such as when the case law applicable to one provision contradicts the other in a way that cannot be rationalized by the differences in the underlying instruments.

Commenters also argued that the negligence standard of Rules 9j-1(a)(3) and (4) would chill or disrupt the security-based swap market and would capture actions, including errors, taken in connection with normal and legitimate business activity due to the nature of security-based swap transactions.[144] However, as discussed, courts have recognized that sections 17(a)(2) and (3) of the Securities Act, on which Rules 9j-1(a)(3) and (4) are based, focus on the person's conduct and the effect of that conduct, rather than the "culpability of the persons responsible."[145] Like Securities Act sections 17(a)(2) and (3), final Rules 9j-1(a)(3) and (4) will not capture normal and legitimate business activity. Courts have found, for example, that the negligence standard requires that to be deemed in violation of these provisions, a defendant must act in a manner contrary to the manner in which a reasonably prudent person in the defendant's position

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142 *See Brian A. Schmidt et al.,* Exchange Act Release No. 45330 (Jan. 24, 2002) (citing *Adena Exploration Inc. v. Sylvan*, 860 F.2d 1242, 1251 (5th Cir. 1988) (citing *Nor-Tex Agencies Inc. v. Jones*, 482 F.2d 1093 (5th Cir. 1973)); *Stier v. Smith*, 473 F.2d 1205, 1207 (5th Cir. 1973) (sophisticated investors, like all others, are entitled to the truth); *Jay Houston Meadows*, 52 S.E.C. 778, 785 (1996), *aff'd*, 119 F.3d 1219 (5th Cir. 1997) (rejecting arguments that the antifraud provisions do not apply to customers who are experienced or sophisticated).

143 The same is true with respect to Rules 9j-1(a)(1) and (2) and section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, which the Supreme Court also addressed in *Aaron*.

144 *See* MFA Letter at 12 (addressing the sophistication of and personal relationships of counterparties to security-based swap transactions as compared to the "impersonal transactions" underlying other types of security transactions); Milbank Letter at 5 (asserting that in light of the pace of activity involved in security-based swap transactions "mere human error" could lead to liability).

145 *Aaron*, 446 U.S. at 696-97.

would have acted under the circumstances.[146] Accordingly, a violation of Rules 9j-1(a)(3) and (4) would require more than a mere mistake.[147]

b. Attempted Conduct

Finally, as proposed, the Rule 9j-1(a) prohibitions would have extended to the attempted fraudulent, manipulative or deceptive conduct described in paragraphs (a)(1) through (4) of the rule. The Commission largely adopts Rule 9j-1(a) as proposed as it relates to attempted conduct, except to address the mental state applicable to attempted conduct by placing the attempted conduct described in paragraphs (3) and (4) of proposed Rule 9j-1 into a standalone paragraph (5) in the final rule. [148]

The inclusion of attempted conduct in Rules 9j-1(a)(1), (2), and (5) is premised on the text of section 9(j). First, the statute expressly prohibits "engag[ing] in any fraudulent, deceptive, or manipulative act or practice, mak[ing] any fictitious quotation, or engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any person" in an "attempt to induce the purchase or sale of, any security-based swap."[149] Moreover, as discussed above, courts have determined that an act, practice, transaction, or course of business can be fraudulent, deceptive, or manipulative, or operate as a fraud or deceit—and thus violate antifraud provisions of the securities laws—regardless of whether it succeeds in its aims.[150]

Second, section 9(j) authorizes the Commission to "prescribe means reasonably designed to prevent" the fraudulent, deceptive, or manipulative conduct that the statute expressly prohibits. The Supreme Court has held that this language allows the Commission to "prohibit

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146 *SEC v. Shanahan*, 646 F.3d 536, 545-46 (8th Cir. 2011).

147 In addition, the affirmative defenses in Rule 9j-1(e) address some of the concerns commenters have with regard to disruption to the security-based swap and loan markets. *See infra* section II.E.

148 *See* Rules 9j-1(a)(1) through (5). In addition, final Rule 9j-1(a) has been revised to include the prohibitions on manipulation and attempted manipulation proposed in Rule 9j-1(b) in a new paragraph (a)(6) with some revision. *See infra* section II.C. The CFTC's antifraud and anti-manipulation rule regarding swaps similarly prohibits attempted conduct. 17 CFR 180.1.

149 15 U.S.C. 78i(j).

150 *See supra* note 112.

acts not themselves fraudulent . . . if the prohibition is 'reasonably designed to prevent . . . acts and practices [that] are fraudulent.'"[151] The Commission is exercising that authority in Rules 9j-1(a)(1), (2), and (5) to prohibit attempts to engage in fraudulent, deceptive, or manipulative acts, practices, transactions, or courses of business. The prohibition applies where a person, with scienter, takes a step in furtherance of a fraudulent, deceptive, or manipulative act, practice, transaction, or course of business but for some reason—including "pure fortuity"[152]—that act, practice, transaction, or course of business is not completed. For example, and without limitation, the prohibition would apply where a supervisor, with scienter, directs a subordinate to make a fraudulent material misstatement or omission, but the subordinate refuses to do so.

Rule 9j-1(a)'s prohibition on such attempted misconduct recognizes that fraud, deception, and manipulation in the security-based swaps market can involve complex strategies implemented over multiple stages, as discussed above in section I.B.2. The prohibition is consistent with other provisions of the securities laws that recognize the importance of Commission intervention before the completion of a fraudulent, deceptive, or manipulative act, practice, transaction, or course of business. The Commission has the authority to seek an injunction whenever "any person is engaged or *is about to engage* in acts or practices constituting a violation of" the Exchange Act or Securities Act.[153] Rule 9j-1(a)'s prohibition of attempts provides the Commission with an additional tool to prevent such misconduct before any harm comes to the security-based swap market or market participants.

One commenter argued against applying the negligence standard applicable to the misconduct prohibited by Rules 9j-1(a)(3) and (4) to attempts to engage in that misconduct because it "may capture conduct that is not itself fraudulent or manipulative" but rather

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151 *O'Hagan*, 521 U.S. at 673 (quoting a similar provision in Exchange Act section 14(e), 15 U.S.C. 78n(e)). *See also id*. at 672-73 ("A prophylactic measure, because its mission is to prevent, typically encompasses more than the core activity prohibited.").

152 *Kuehnert*, 412 F.2d at 704.

153 15 U.S.C. 78u(d) (emphasis added) (Exchange Act); 15 U.S.C. 77t(b) (Securities Act). *See, e.g., Kuehnert*, 412 F.2d at 704 ("The Commission may act . . . to enjoin a potential fraud or prosecute a fraud that failed, without proof of actual loss to any victim.").

"legitimate business activities" and would have a "chilling effect on the market for security-based swaps."[154] Another commenter noted that sections 17(a)(2) and (3) of the Securities Act do not prohibit "attempts" and that "the Commission should either eliminate the reference to attempts in Rules 9j-1(a)(3) and (4)" or clarify the standard required for liability for attempted conduct prohibited under those paragraphs of Rule 9j-1.[155] Similarly, one commenter believed that including attempts within the scope of conduct covered by Rule 9j-1 was broader than the scope of conduct covered by section 17(a) of the Securities Act and warranted the application of an intent standard.[156]

Although, as discussed above, the Commission disagrees with assertions that a different standard would capture legitimate business decisions,[157] we nevertheless agree that scienter is the proper standard for attempts at conduct that would violate paragraphs (a)(3) or (a)(4) of final Rule 9j-1.[158] Therefore, while final Rule 9j-1 retains the non-scienter-based standard for the underlying conduct described in paragraphs (a)(3) and (4), the Commission is revising the final rule in order to separate the attempted conduct from paragraphs (a)(3) and (4) of proposed Rule 9j-1 into a new paragraph (a)(5). Scienter is the standard that will apply to Rule 9j-1(a)(5).

B. Prohibition on Price Manipulation

1. Proposed Approach

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154 LSTA Letter at 7.

155 *See* IIB-ISDA-SIFMA Letter at 13 (arguing that "[p]arties cannot be held to a standard of strict liability with regards to fluid discussions in the course of negotiating complex transactions—not to mention the potential for good faith mistakes to arise in connection with ongoing payment and delivery obligations").

156 *See* MFA Letter at 12. *See also* IIB-ISDA-SIFMA Letter at 13 (arguing for a different standard for attempted conduct).

157 *See supra* notes 144-147 and accompanying text.

158 In other contexts, courts have recognized that a scienter standard may be appropriate for attempts even when it is not required for the violation attempted. *See, e.g.*, *United States v. Cote*, 504 F.3d 682, 687 (7th Cir. 2007). *See also United States v. Gracidas-Ulibarry*, 231 F.3d 1188, 1192 (9th Cir. 2000) (recognizing "the doctrine that the crime of attempt requires a showing of specific intent even if the crime attempted does not" (internal quotation marks omitted)).

Partly in response to manufactured credit events and other opportunistic CDS strategies observed over the last decade,[159] paragraph (b) of proposed Rule 9j-1 was designed to address price manipulation and attempted price manipulation, similar to 17 CFR 180.2 ("CFTC Rule 180.2").[160] Paragraph (b) of proposed Rule 9j-1 would have made it unlawful for any person to, directly or indirectly, manipulate or attempt to manipulate the price or valuation of any security-based swap, or any payment or delivery related thereto.

Proposed Rule 9j-1(b) was designed to capture misconduct such as situations in which a payment under the security-based swap is intentionally or recklessly distorted for the benefit of one of the security-based swap counterparties or situations in which a person intentionally or recklessly causes or avoids the purchase or sale of a security-based swap for the benefit of one counterparty. The proposed rule was not designed to capture affirmative actions taken in the ordinary course of a security-based swap transaction or the reference underlying security.[161] In this regard, the 2021 Proposing Release stated that a determination as to whether manipulation or attempted manipulation under Rule 9j-1(b) occurred would largely depend on the facts and circumstances of each particular situation. However, as a general matter the Commission would expect to use its authority to bring an enforcement action under Rule 9j-1(b) when a party took action for the purposes of avoiding or causing, or increasing or decreasing, a payment under a security-based swap in a manner that would not have occurred but for such actions, or when an action appeared to be designed almost exclusively to harm a counterparty.[162] The Commission specifically stated in the 2021 Proposing Release that its intent was not to discourage lenders and

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159 *See supra* section I.B.2. *See also* 2021 Proposing Release, 87 FR at 6654-55 (discussing the manufactured credit events and other opportunistic strategies in the CDS market identified by the Commission that "may adversely affect the integrity, confidence, and reputation of the credit derivatives markets) (quoting the 2019 Joint Statement). To be clear, Rule 9j-1, including Rule 9j-1(b), applies to all security-based swaps and is not limited to CDS.

160 *See* 17 CFR 180.2.

161 *See* 2021 Proposing Release, 87 FR at 6663.

162 *Id.*

prospective lenders from discussing or providing financing or other forms of relief to reference entities to avoid defaulting on their debt.

2. Commission Action

The Commission is adopting a price manipulation rule as proposed in Rule 9j-1(b), but as a new paragraph (6) to Rule 9j-1(a). Consistent with the revisions to Rule 9j-1(a) discussed above in section II.A, the placement of the price manipulation rule in a new paragraph to Rule 9j-1(a), rather than in standalone paragraph 9j-1(b) as proposed, clarifies that the prohibited manipulative conduct must occur in connection with effecting, or attempting to effect a transaction in any security-based swap or in connection with purchasing or selling, or inducing or attempting to induce the purchase or sale, of any security-based swap.[163] We discuss this change in more detail below.

The Commission received multiple comment letters specifically addressing paragraph (b) of proposed Rule 9j-1. One commenter was supportive of proposed Rule 9j-1(b) and the application of a "facts and circumstances" analysis to determine whether conduct in connection with a security-based swap is manipulative.[164] Another commenter supported the Commission's addition of paragraph (b) to "better protect the fairness of markets, and better enable appropriate enforcement to police abuses in the swaps markets."[165]

However, most of the comments addressing paragraph (b) of proposed Rule 9j-1 argued against the new provision or asked for added clarity.[166] One commenter argued that the Commission's guidance with regard to the standard to be applied to determine liability under the

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163 *See* Rule 9j-1(a)(6).

164 *See* Fletcher Letter at 2 (stating that a facts and circumstances "approach avoids bright-line rules that potentially create opportunities to engage in manipulative behavior within the letter but not the spirit of the law, and provides the staff of the Commission with the flexibility it needs to evaluate transactions in an ever-evolving marketplace").

165 AFRED Letter at 4-5 (stating specifically that Rule 9j-1 would enable the Commission "to crack down on fraudulent conduct in the [CDS] market that unnecessarily triggers a counterparty to post collateral related to a default for the CDS buyers' benefit").

166 *See* Milbank Letter at 2-5; MFA Letter at 17-18; LSTA Letter at 6; IIB-ISDA-SIFMA Letter at 13-15.

proposed rule was insufficient and that it was unclear how courts would apply the standard absent a "deceptive intent" requirement.[167]

The Commission has carefully considered the comments. The Commission is adopting final Rule 9j-1(a)(6) to prohibit manipulation and attempted manipulation of the price or valuation of any security-based swap, including any payment or delivery related thereto, in connection with effecting or attempting to effect a transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap. The Commission will apply a scienter standard—which includes intentional or reckless misconduct—to determine whether conduct is in violation of final Rule 9j-1(a)(6).[168]

Many of the commenters critical of proposed Rule 9j-1(b) believed that it was too broad and would lack clarity in application, thereby leading to a chilling effect on the security-based swap market and the credit market.[169] Several commenters focused on the "facts and circumstances analysis" described by the Commission in proposing Rule 9j-1(b) for determining whether a violation of the rule has occurred. In general, these commenters believed that the facts and circumstances test was not an adequate standard to determine when manipulation or attempted manipulation prohibited by proposed Rule 9j-1(b) occurred. One commenter pointed to the standard articulated by the CFTC in the enforcement of CFTC Rule 180.2 to argue for a

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167 Milbank Letter at 3 (citing case law in which "anti-manipulation provisions of existing securities laws are generally interpreted . . . to prohibit conduct that is intended to deceive investors by artificially affecting market activity or prices, with deceptive intent being an essential element for conduct to be considered 'manipulative'").

168 Courts have found that use of the term "manipulative" in the statute would evidence a Congressional intent to proscribe only knowing or intentional misconduct and that, accordingly, the Commission must establish that the misconduct was made with scienter. *See*, *e.g.*, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). The Supreme Court has defined scienter as "a mental state embracing intent to deceive, manipulate or defraud." *Id*. In addition, scienter may also be established by a finding of recklessness. *See*, *e.g.*, *Sunstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977).

169 *See*, *e.g.*, Milbank Letter at 2 (arguing that the provision is overbroad and ambiguous and that the Commission should provide "additional clarity as to the standard that would apply to claims brought under proposed Rule 9j-1(b)"); MFA Letter at 17-18 (positing that the scope of the provision is overly broad and that "market participants will reduce their lending activity as well as their security-based swap and securities market activity, or avoid certain markets altogether"); LSTA Letter at 6 (finding that the provision introduces additional uncertainty for lenders).

clearer standard regarding manipulative conduct.[170] When adopting CFTC Rule 180.2, the CFTC reiterated that it would be guided by a four-part test for manipulation that it had developed in case law under sections 6(c)[171] and 9(a)(2)[172] of the Commodity Exchange Act to determine whether to apply CFTC Rule 180.2. Under this four-part test, to bring action, the CFTC would consider "(1) [t]hat the accused had the ability to influence market prices; (2) that the accused specifically intended to create or effect a price or price trend that does not reflect legitimate forces of supply and demand; (3) that artificial prices existed; and (4) that the accused caused the artificial prices."[173] Another commenter pointed to the amended definition of "Failure to Pay" in the ISDA Credit Derivatives Definition as an example of the type of guidance the commenter believed would be helpful to market participants in determining what actions may be construed as misconduct or manipulation.[174]

Similarly, one commenter believed that proposed Rule 9j-1(b) included a "manipulation standard that is new to securities markets" and requested further guidance or definition to avoid "the chilling effect that a poorly-understood standard could have on legitimate conduct."[175] In the commenter's view, "the Commission should articulate as precisely as possible (a) what potential

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170 *See* MFA Letter at 18 ("The CFTC's anti-manipulation rules applicable to swap transactions, which are similar and analogous to security-based swaps in many respects, set out a much clearer standard regarding manipulative conduct."). CFTC Rule 180.2 addresses price manipulation and provides that "[i]t shall be unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity." Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 FR 41398, 41707 (July 14, 2011) ("CFTC Rule 180.2 Adopting Release").

171 7 U.S.C. 6c.

172 7 U.S.C. 13(a)(2).

173 *See* CFTC Rule 180.2 Adopting Release, 76 FR at 41407. In addition, a violation of CFTC Rule 180.2 requires a showing of "specific intent." *Id*. ("[The CFTC] reaffirms the requirement under final Rule 180.2 that a person must act with the requisite specific intent. In other words, recklessness will not suffice under final Rule 180.2 as it will under final Rule 180.1."). In contrast, for purposes of liability under Rule 9j-1, scienter includes recklessness as established by a long line of case law. *See supra* note 129.

174 Letter from Jennifer Han, Managed Funds Association, dated July 8, 2022 ("July 2022 MFA Letter"), at 5-7. In 2019, ISDA introduced amendments to its Credit Derivatives Definitions designed to address certain issues related to manufactured credit events, which ISDA termed "narrowly tailored credit events" ("ISDA Amendments"). *See* 2019 Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definition (July 15, 2019), available at https://www.isda.org/a/KDqME/Final-NTCE-Supplement.pdf.

175 IIB-ISDA-SIFMA Letter at 13.

conduct or activity is targeted, (b) which market participants would be harmed by it, and (c) why it is that the existing market infrastructure (whether the existing anti-fraud rules or the provisions of the relevant contracts) does not already provide sufficient protection."[176] A significant concern for the commenter was whether market participants would be able to determine that their actions were manipulative and in violation of proposed Rule 9j-1(b). Absent a clear standard, they argued that market participants may determine to reduce their activity, which would have broad negative impacts on liquidity in the security-based swap market and broader economy.[177] Finally, the commenter requested that the Commission provide guidance with regard to the types of conduct or activities that would violate proposed Rule 9j-1(b) and those that would not violate proposed Rule 9j-1(b) under any implemented "facts and circumstances" test.[178] A separate commenter requested that the Commission "tailor" proposed Rule 9j-1(b) so that it includes a specific description of what constitutes manipulative conduct.[179]

The Commission is revising the price manipulation provision, originally proposed as Rule 9j-1(b) and adopted as final Rule 9j-1(a)(6), in response to the comments above. Consistent with the revisions to final Rule 9j-1(a) discussed above in section II.A, Rule 9j-1(a)(6) will apply to conduct undertaken in connection with effecting or attempting to effect a transaction in any security-based swap, and to purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap (including but not limited to, in whole or in part, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security based-

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176 *Id.* at 14 (stating that care should be taken to correctly analyze the potential impact of new manipulation standards such as that in Rule 9j-1(b)).

177 *Id.* at 13-14.

178 *Id.* at 16.

179 *See* MFA July 2022 Letter at 10. The commenter also believed that the Commission should re-propose Rule 9j-1(b) for public comment to allow market participants "to adequately assess the potential impact of [proposed Rule 9j-1(b)] on the security-based swap markets and . . . on the broader market for corporate debt." *Id.*

swap).[180] As the Supreme Court has stated, "fraudulent manipulation of [securities] prices . . . unquestionably qualifies as a fraud 'in connection with the purchase or sale' of securities."[181] Rule 9j-1(a)(6) also prohibits the manipulation (or attempted manipulation) of the valuation of any security-based swap, or any payment or delivery related thereto, to the extent such misconduct is in connection with effecting or attempting to effect a transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap.[182]

A determination as to whether a person has violated final Rule 9j-1(a)(6) will depend on the facts and circumstances of each particular situation. The assessment of facts and circumstances is an objective evaluation that considers all relevant information surrounding the alleged misconduct, including both quantitative and qualitative factors, to determine whether prohibited manipulation is present. A "facts and circumstances" analysis will provide the Commission with the flexibility it needs to address an evolving security-based swap market, including the ever-changing CDS market, and potential misconduct in those markets. Bright line rules or tests, on the other hand, may artificially exclude manipulative and attempted manipulative conduct and could create a roadmap for market participants to avoid liability for manipulative actions. A substantial body of case law regarding manipulative behavior exists with regard to other antifraud and anti-manipulation provisions in the Securities Act and Exchange Act to which the Commission will look to assess whether a violation of Rule 9j-1(a)(6) has occurred.[183] In addition, the Commission reiterates that case law requires a showing of scienter to

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180 *See supra* section II.A.

181 *Dabit*, 547 U.S. at 89.

182 The Commission has the authority to prohibit attempted manipulation based on section 9(j)'s application to "attempt[s] to induce the purchase or sale of" any security-based swap, as well as case law establishing that manipulative conduct need not be successful to violate the securities laws. *See supra* note 112.

183 *See*, *e.g.*, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976); *Markowski v. SEC*, 274 F.3d 525 (D.C. Cir. 2001); *United States v. Mulheren*, 938 F.2d 364 (2d Cir. 1991); *SEC v. Malenfant*, 784 F. Supp. 141, 144 (S.D.N.Y. 1992); *SEC v.* Markusen, 2016 U.S. Dist. LEXIS 55419 (D. Minn. Apr. 25, 2016); *Sharette v. Credit Suisse Intern*, 127 F. Supp. 3d 60 (S.D.N.Y. 2015); *ATSI Communications, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87 (2d Cir. 2007); *Wilson v. Merrill Lynch & Co.*, 671 F.3d 120 (2d Cir. 2011); *SEC v. Schiffer*, 1998 U.S. Dist. LEXIS 8579 (S.D.N.Y. June 10, 1998).

bring an action for manipulation or attempted manipulation and that it will apply a scienter standard to determine whether conduct is in violation of Rule 9j-1(a)(6).

Also, as noted, commenters encouraged the Commission to explicitly recognize certain market activities as legitimate.[184] The Commission declines to carve out from the application of Rule 9j-1(a)(6) categories of market activities based on hypothetical fact patterns as requested by commenters. Liability under Rule 9j-1(a)(6) will depend upon an analysis of *all* relevant information. A different approach could artificially exclude manipulative conduct, particularly given the complex fact patterns generally at issue in many security-based swap transactions. As discussed in the 2021 Proposing Release, Rule 9j-1(a)(6) applies to actions taken outside the ordinary course of a typical lender-borrower relationship, such as an action taken for the purposes of avoiding or causing, or increasing or decreasing, a payment under a security-based swap in a manner that would not have occurred but for such actions, or when an action appears to be designed almost exclusively to harm counterparties, and is not intended to discourage lenders from discussing or providing financing or relief to avoid default.[185] Moreover, the fact that the Commission will apply a scienter standard for liability under Rule 9j-1(a)(6) should lessen concerns regarding any "chilling effects" of the new rule.[186] Further, as discussed in section II.E.2, the affirmative defenses of final Rule 9j-1(e) do not apply to the anti-manipulation provision in Rule 9j-1(a)(6) because paragraph (a)(6) does not apply to affirmative actions taken in the ordinary course of a security-based swap transaction or the reference underlying security while aware of material nonpublic information. To be clear, Rule 9j-1(a)(6) will require that security-based swap market participants take care that their legitimate market activities remain

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184 *See* IIB-ISDA-SIFMA Letter at 15-23.

185 *See* 2021 Proposing Release, 87 FR at 6663. As discussed above, the text of revised Rule 9j-1(a) also specifies that such actions must occur in connection with effecting or attempting to effect a transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap.

186 *See* Letter from Som-lok Leung, International Association of Credit Portfolio Managers ("IACPM"), dated Mar. 21, 2022 ("IACPM Letter"), at 4; MFA Letter at 8-10; LSTA Letter at 5, 7-10; IIB-ISDA-SIFMA Letter at 13-22.

within the scope of the typical lender-borrower relationship and do not cross the line into prohibited manipulation. However, the use of a facts and circumstances analysis, along with the use of a scienter standard, to identify manipulative conduct addresses commenters concerns that legitimate market activities would be captured by the prohibitions of Rule 9j-1(a)(6) or otherwise chilled.

However, to further address commenter concerns, the Commission reiterates that Rule 9j-1(a)(6) prohibits, among other things, a situation where a person (or group of persons) intentionally or recklessly causes or avoids the purchase or sale of a security-based swap for the benefit of a counterparty, or to harm a counterparty, to a security-based swap. This may include, for example, orphaning a CDS,[187] avoiding termination of a CDS for a period of time, or causing the termination of a CDS. But a person simply profiting from a CDS position after a company's bankruptcy, which such person could have prevented by participating in a financing to the company, without more, is not in and of itself improper conduct for purposes of Rule 9j-1(a)(6).

The Commission also recognizes that reference entities often rely on financing and other forms of relief to avoid defaulting on their debt. We understand that CDS transactions are an important means by which debt holders hedge their underlying debt instruments, and that the absence of such hedging opportunities could impact prospective investors' willingness and ability to invest in that underlying market. The final rule is not intended to discourage lenders and prospective lenders from discussing or providing such financing or relief, even when those persons also hold CDS positions. Rather, the Commission is adopting Rule 9j-1(a)(6) to account for actions taken outside the ordinary course of a typical lender-borrower relationship (or a prospective lender-borrower relationship). Although, as discussed, any such determination would need to be based on the facts and circumstances of a particular situation, as a general matter an

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[187] "Orphaning" a CDS refers to a situation where the debt of a reference entity is eliminated or reduced for the purposes of moving the price of CDS. The end result of such activity is that CDS buyers continue to pay (and CDS sellers continue to receive) premiums on CDS that will never default. Similarly, a CDS protection seller could offer financing to the company to avoid a credit event and subsequent CDS payout, with the financing timed so that the company's bankruptcy is merely delayed until after the CDS expires.

action that appears to be designed almost exclusively to harm one or more CDS counterparties would likely fall within the prohibition in Rule 9j-1(a)(6). Security-based swap market participants should and can take care that their legitimate market activities remain within the scope of the typical lender-borrower relationship and do not cross the line into prohibited manipulation. Using a "facts and circumstances" analysis to identify conduct that is prohibited by Rule 9j-1(a)(6), the Commission will consider all relevant facts in any attempt to determine whether prohibited manipulation or attempted manipulation has occurred. Further, the Commission will apply a scienter standard, which will work to eliminate legitimate conduct from the scope of Rule 9j-1(a)(6). As discussed above, the adoption of a "facts and circumstances" analysis is appropriate given the complex fact patterns in many security-based swap transactions.

Proposed Rule 9j-1(b) was intended to address, among other things, a number of the manufactured credit events or other opportunistic strategies in the CDS market observed over the last decade.[188] In re-proposing Rule 9j-1, the Commission provided specific examples of manufactured or other opportunistic CDS strategies that had been reported by academics and the press.[189] Commenters raised concerns both that industry efforts, such as the ISDA Amendments and anti-net short provisions, have successfully addressed opportunistic strategies such as those described in the 2021 Proposing Release,[190] and that the description of the manufactured credit events or opportunistic strategies identified by the Commission were "overly-broad and capture legitimate market activities."[191] One commenter asked the Commission to "refine the descriptions of" manufactured credit events or opportunistic strategies that they believe are too broad and have been addressed by industry efforts.[192] With regard to industry efforts, the anti-net

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188 *See* 2021 Proposing Release, 87 FR at 6663.

189 *See supra* section I.B.2. *See also* 2021 Proposing Release, 87 FR at 6654-55 (describing in more detail examples of manufactured credit events and other opportunistic strategies in the CDS market reported by academics and the press).

190 *See* IIB-ISDA-SIFMA Letter at 19-20; LSTA Letter at 4; MFA July 2022 Letter at 4-10; Milbank Letter at 6.

191 IIB-ISDA-SIFMA Letter at 20-23.

192 *See* IIB-ISDA-SIFMA Letter at 19.

short provisions and ISDA Amendments are narrowly focused and have limited ability to reduce fraudulent and manipulative activity in the security-based swap market. The ISDA Amendments do not address all of the concerns identified in the 2019 Joint Statement, including, but not limited to, addressing opportunistic strategies that do not involve narrowly tailored credit events.[193] Anti-net short provisions are limited to syndicated bank loans and would not apply to fraudulent activity in the security-based swap market that does not involve such loans. Thus, even if these industry efforts were successful in reducing fraudulent activity, their impact likely would be limited by their narrow scope. In response to requests to refine the descriptions of manufactured credit events in the 2021 Proposing Release, the Commission agrees that there may be circumstances in which the types of conduct described may not be the result of manipulation or attempted manipulation; however, the facts and circumstances analysis and scienter standard sufficiently tailor final Rule 9j-1(a)(6) to properly capture manipulative conduct. Therefore, the Commission declines to revise the descriptions.

One commenter requested that the "valuation" prong of proposed Rule 9j-1(b) be removed because "a prohibition on manipulation of the 'valuation' of an asset does not exist in any U.S. regulatory context and would require a new body of case law to be formed to determine how any such new prohibition should be interpreted."[194] The commenter argued that case law focuses on divergences between price and value and that "no analogy can be drawn in cases where it is the change in value that is prohibited."[195] The Commission declines to remove the manipulation of a security-based swap's valuation from the scope of Rule 9j-1(a)(6) because the pricing and valuation of security-based swaps are intrinsically connected. For example, although CDS pricing can be complex, "[t]he basic idea of CDS pricing is that the present value of all the

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193 *See* 2021 Proposing Release, 87 FR at 6655 n.31.

194 Milbank Letter at 3 (citing to *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 476 (1977), to argue that "'[m]anipulation' is 'virtually a term of art when used in connection with securities markets' . . . The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity").

195 Milbank Letter at 3.

CDS premium payments should equal to the present value of the expected payoff from the CDS for the [net present value] to be 0 for both parties of the contract (resulting in each party being equally well off)."[196] In other words, a CDS typically is priced to allow the protection seller to recover its potential cash outflows upon a credit event and termination of the CDS, or its "expected loss." The protection seller will determine the value of the expected loss based on several factors, including the likelihood of default and cost of capital. The value of the expected loss drives the price of the CDS and the payout upon termination of the CDS. Similarly, the price of a TRS typically is the difference between the present value of both "legs" of the transaction's cash flows. Therefore, actions to manipulate price will affect valuation and vice versa. Additionally, market participants may rely on models to price or value the swap.[197] This suggests that "valuation" of a security-based swap has a role in the market and should be included in the anti-manipulation provisions of Rule 9j-1(a)(6). Further, by prohibiting the manipulation of a security-based swap's valuation, Rule 9j-1(a)(6) will help to prevent manipulation of payments and deliveries under a security-based swap "from distorting the price and market for such security-based swaps, as well as for the reference underlying, and improperly interfering with the independent and proper functioning of the markets."[198]

Rule 9j-1(a)(6) prohibits manipulation in connection with effecting or attempting to effect a transaction in, any security-based swap, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap, which may include intentionally or recklessly distorting payments related to a security-based swap to benefit, or

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196 Yuan Wen and Jacob Kinsella, Credit Default Swap – Pricing Theory, Real Data Analysis and Classroom Applications Using Bloomberg Terminal, available at https://data.bloomberglp.com/bat/sites/3/2016/10/WhitePaper_Wen.pdf.

197 The Commission has previously recognized that market participants may rely on models for pricing and valuation of security-based swaps. *See, e.g.*, Business Conduct Standards Adopting Release, 81 FR at 29988 (in the context of daily marks, stating that "even if the mark is calculated based on internal models or such indices, its provision by the SBS Entity will further the goal of providing helpful transparency into the SBS Entity's pricing and valuation of the security-based swap by providing a helpful reference point that the SBS Entity's counterparty can take into account when evaluating the pricing and valuation of the SBS.").

198 2010 Rule 9j-1 Proposing Release, 75 FR at 68565-66.

harm, one of the security-based swap counterparties, or actions that serve little to no economic purpose other than to artificially influence the composition of the deliverable obligations in a CDS auction and affect the security-based swap's valuation and price. To remove the valuation prong from final Rule 9j-1(a)(6) would create a gap in the prohibition against the manipulation or attempted manipulation of prices in the security-based swap market.

D. Liability Under Rules 9j-1(b) and (c)

1. Proposed Approach

The Commission included paragraphs (c) and (d) of re-proposed Rule 9j-1 to make it clear that market participants could not avoid liability under the rule by effecting a fraudulent scheme through the purchase or sale of an underlying security, rather than the purchase or sale of the security-based swap on which it is based, and vice versa. The first of those two provisions would have provided that a person could not escape liability for trading based on possession of material nonpublic information about a security by purchasing or selling a security-based swap based on that security (as opposed to trading in the security itself). The second provision would have provided that a person could not escape liability under section 9(j) or Rule 9j-1 by purchasing or selling the underlying security (as opposed to purchasing or selling a security-based swap that is based on that security).

2. Commission Action

One commenter specifically addressed these provisions and was supportive, noting that the antifraud and anti-manipulation provisions in proposed Rules 9j-1(a) and (b) would be enhanced by the addition of proposed Rules 9j-1(c) and (d).[199] In contrast, one commenter questioned the Commission's authority to extend the prohibitions of Rule 9j-1 to the purchase and sale of underlying securities.[200] After considering these comments, the Commission adopts

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199 *See* Better Markets Letter at 9.

200 *See* MFA Letter at 8-9.

Rules 9j-1(c) and (d) largely as proposed but renumbered as final Rules 9j-1(b) and (c), respectively.

a. Rule 9j-1(b)

The Commission is adopting Rule 9j-1(b), as proposed in paragraph (c). Final Rule 9j-1(b) provides that wherever communicating, or purchasing or selling a security (other than a security-based swap) while in possession of, material nonpublic information would violate, or result in liability to any purchaser or seller of the security under either the Exchange Act or the Securities Act, or any rule or regulation thereunder, such conduct in connection with a purchase or sale of a security-based swap with respect to such security or with respect to a group or index of securities including such security shall also violate, and result in comparable liability to any purchaser or seller of that security under such provision, rule, or regulation.[201]

Although generally a situation where a person uses material nonpublic information about a security in connection with the purchase or sale of a security-based swap would be subject to the existing antifraud authority under the Federal securities laws, particularly section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, market participants also would benefit from a clarified interpretation of that statutory provision in this rulemaking.[202] This is particularly true given that the issuer of a security-based swap (*i.e.*, each counterparty to the transaction) is different from the issuer of the underlying security (*i.e.,* the reference entity). Accordingly, the Commission is now adopting Rule 9j-1(b) to provide that a person making a purchase or sale of a

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201 Final Rule 9j-1(b) includes non-substantive corrections to punctuation.

202 Pursuant to section 20(d) of the Exchange Act, a person with material nonpublic information about a security cannot avoid liability under the securities laws by making purchases or sales in a swap on a broad-based index containing the security (*e.g.*, the S&P 500), which would be a security-based swap agreement, whereas the statute is silent as to the permissibility of trading on such material nonpublic information by making purchases or sales of a security-based swap (*e.g.*, a swap on the security itself). The Commission does not construe that silence as an intent to exclude security-based swaps from the scope of section 20(d) and the Commission has the authority under section 9(j) to prescribe means reasonably designed to prevent fraud, manipulation, or deceit with respect to security-based swap transactions. In addition, Section 9(j) makes it unlawful for any person to directly or indirectly take the actions described in that section.

security-based swap while in possession of material nonpublic information with respect to the security underlying such security-based swap is subject to liability.

b. Rule 9j-1(c)

The Commission also is adopting Rule 9j-1(c) largely as it was proposed as paragraph (d), with a clarifying edit as discussed below.[203] Final Rule 9j-1(c) will address a situation similar to the one described above. Specifically, it provides that wherever taking any of the actions set forth in Rule 9j-1(a) involving a security-based swap would violate, or result in liability under section 9(j) of the Exchange Act or Rule 9j-1(a), such conduct, when taken by a counterparty to such security-based swap (or any affiliate of, or a person acting in concert with, such security-based swap counterparty in furtherance of such prohibited activity), in connection with a purchase or sale of a security, loan, or group or index of securities on which such security-based swap is based shall also violate, and shall be deemed a violation of, section 9(j) or Rule 9j-1(a). The adopted rule text is modified from the 2021 Proposing Release to now include a reference to "loan." The addition clarifies the scope of underlying products that apply, and is consistent with the underlying products included in the definition of "security-based swap" in section 3(a)(68)(A) of the Exchange Act.[204]

This provision prevents a person from escaping liability under section 9(j) or Rule 9j-1(a) with respect to a security-based swap by limiting all of its actions to purchases or sales of the security, loan, or narrow-based security index underlying that security-based swap. For example, if a person with an existing total return swap on equity securities issued by XYZ Corporation subsequently engages in a number of wash trades to artificially inflate the price of the equity securities in order to benefit from the manipulated price by way of their existing security-based

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203 In addition, final Rule 9j-1(c) includes non-substantive corrections to punctuation and two non-substantive revisions: (1) the word "whenever" at the start of the paragraph has been replaced with the word "wherever" to be consistent with the language in paragraph (b); and (2) the references to "paragraphs (a) or (b)" of Rule 9j-1 have been replaced with just a reference to "paragraph (a)" to reflect the placement of paragraph (b) of proposed Rule 9j-1 into a new paragraph (a)(6) of final Rule 9j-1.

204 *See* 15 U.S.C. 78c(68)(A).

swap position, such person would be liable for violations of Exchange Act section 9(j) and Rule 9j-1 regardless of the fact the manipulation was conducted through purchases or sales of the equity securities.

In response to the commenter who questioned the Commission's authority to extend the prohibitions of Rule 9j-1 to the purchase or sale of underlying securities,[205] the Commission clarifies that final Rule 9j-1(c) does not create a separate category of prohibited activity absent a connection to security-based swaps. Rather, this provision is reasonably designed to prevent fraud, manipulation, or deceit with respect to security-based swaps where that misconduct is accomplished through transactions in the underlying security, loan, or group or index of securities. This provision is necessary because security-based swaps by their nature are tied intrinsically to activity in the markets for other securities.

Moreover, this provision does not impose liability on a person for violations of section 9(j) of the Exchange Act and Rule 9j-1 based solely on the impact of that person's purchases or sales on the equity, debt, or loan markets. The rule states that the person engaged in prohibited activities in the equity, debt, or loan markets must be a counterparty to a security-based swap that references such equity or debt securities or loan, or be an affiliate of, or a person acting in concert with, such security-based swap counterparty in furtherance of such prohibited activity. Accordingly, the Commission would analyze whether transactions in the underlying equity or debt securities or loan have been used as the mechanism to violate section 9(j) and Rule 9j-1. The Commission would also analyze the same transactions to determine whether they independently violate other antifraud and anti-manipulation provisions of the securities laws—including sections 9 and 10(b) of the Exchange Act, and Rule 10b-5 thereunder, as well as section 17(a) of the Securities Act.

E. Safe Harbors and Affirmative Defenses

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205 MFA Letter at 9.

1. Proposed Approach

In response to operational concerns raised by commenters with regard to the 2010 Proposed Rule, the Commission proposed two limited safe harbors from re-proposed Rule 9j-1(a) to address situations when a counterparty to a security-based swap was required to take certain actions while in possession of material nonpublic information.[206] First, proposed Rule 9j-1(f)(1), would have allowed a person to take action in accordance with binding contractual rights and obligations under a security-based swap (as reflected in the written security-based swap documentation governing such transaction or any amendment thereto), so long as the person could demonstrate that: (1) the security-based swap was entered into, or the amendment was made, before the person became aware of such material nonpublic information; and (2) the entry into, and the terms of, the security-based swap were themselves not a violation of any provision of proposed Rule 9j-1(a).[207]

Second, recognizing the important operational benefits and market efficiencies related to security-based swap portfolio compression, proposed Rule 9j-1(f)(2) would have provided a safe harbor for transactions effected in connection with certain types of bilateral or multilateral portfolio compression exercises.[208] This proposed safe harbor would have provided that a person would not be liable under re-proposed Rule 9j-1(a) solely for reason of being aware of material nonpublic information for "security-based swap transactions effected by a person pursuant to a bilateral portfolio compression exercise (as defined in § 240.15Fi-1(a)) or a multilateral portfolio compression exercise (as defined in § 240.15Fi-1(j)) so long as: (i) any such transactions are consistent with all of the terms of a bilateral portfolio compression exercise or multilateral portfolio compression exercise, including as it relates to, without limitation, the transactions to be included in the exercise, the risk tolerances of the persons participating in the exercise, and

206 *See* 2021 Proposing Release, 87 FR at 6662, 6662 n.87.

207 *Id.* at 6662.

208 *See id.* at 6662-63.

the methodology used in the exercise; and (ii) all such terms were agreed to by all participants of the bilateral portfolio compression exercise or multilateral portfolio compression exercise prior to the commencement of the applicable exercise."[209]

2. Commission Action

As discussed above, in response to operational concerns raised in response to the 2010 Proposed Rule, the Commission included two limited safe harbors from re-proposed Rule 9j-1(a).[210] After further consideration and as described in more detail below, the Commission is not adopting either proposed safe harbor. Instead, the Commission is adopting two affirmative defenses from Rules 9j-1(a)(1) through (a)(5). One affirmative defense is for actions taken in connection with the binding contractual rights and obligations under a security-based swap (similar to the proposed safe harbor). The other affirmative defense takes account of reasonable policies and procedures that ensure that individuals making investment decisions are not engaging in prohibited conduct in final Rules 9j-1(a)(1) through (a)(5). These affirmative defenses, while not identical to the affirmative defenses under Rule 10b5-1, are similar in that they apply to situations in which a person can demonstrate that material nonpublic information did not factor into their investment decision.

Consistent with the analogous provisions of Rule 10b5-1, final Rule 9j-1 does not provide for an affirmative defense for violations of the anti-manipulation provision in Rule 9j-1(a)(6). Paragraph (a)(6) of Rule 9j-1 does not apply to actions that the affirmative defenses address: those taken in the ordinary course of a security-based swap transaction (including actions related to the reference underlying security) while aware of material nonpublic information.[211]

Several commenters urged the Commission to make the affirmative defenses under Rule 10b5-1 available under Rule 9j-1, to address situations in which a counterparty comes into

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209 Re-proposed Rule 9j-1(f)(2); 2021 Proposing Release, 87 FR at 6662.

210 *See* 2021 Proposing Release, 87 FR at 6660-62.

211 Final Rule 9j-1(a)(6) is discussed in section II.C above.

possession of material nonpublic information during the life of a security-based swap.[212] Rule 10b5-1 applies to insider trading cases under section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and includes affirmative defenses for: (1) purchases or sales pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account, or a written trading plan under certain conditions;[213] and (2) transactions by an entity if the individual making the investment decision on behalf of the entity was not aware of the material nonpublic information and the entity had implemented reasonable policies and procedures to ensure that the individuals making investment decisions would not violate insider trading laws.[214]

Several commenters noted that most security-based swap market participants are global financial firms that have spent considerable resources to meet the requirements of current Rule 10b5-1(c)(2), by separating their organizations so that individuals on the public side can engage in dealing and market-making activity, while individuals on the private side are allowed to possess material nonpublic information.[215] One commenter stated that the current policies and procedures restrict access to material nonpublic information by those individuals who engage in security-based swap transactions for hedging or other purposes.[216] Since neither of the Rule 10b5-1 defenses explicitly applied to proposed Rule 9j-1 for security-based swaps, one commenter noted the "confusion and regulatory uncertainty" that would be created with the omission of a Rule 10b5-1(c)(2)-type defense from Rule 9j-1 (because identical conduct in the

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212 *See* ACLI Letter at 2, 5; IIB-ISDA-SIFMA Letter at 4-5, 10; MFA Letter at 13-16; LSTA Letter at 9; Letter from Lindsey Weber Kiljo and William C. Thum, Asset Management Group of SIFMA ("SIFMA AMG"), dated Mar. 21, 2022 ("SIFMA AMG Letter"), at 11-12.

213 *See* 17 CFR 240.10b5-1(c)(1) ("Rule 10b5-1(c)(1)").

214 *See* 17 CFR 240.10b5-1(c)(2) ("Rule 10b5-1(c)(2)").

215 *See* IACPM Letter at 4; IIB-ISDA-SIFMA Letter at 5; MFA Letter at 13-14.

216 *See* LSTA Letter at 9.

context of a security-based swap transaction could implicate both Rule 10b-5 and Rule 9j-1, but the affirmative defense would only be available under Rule 10b-5).[217]

In addition, certain commenters expressed concern with the operational impacts of Rule 9j-1(a) on the capital and loan markets. One commenter argued that the application of proposed Rule 9j-1 to the ongoing, "non-volitional" rights and obligations that occur throughout the life of a security-based swap could "cast uncertainty on a wide range of bona fide conduct necessary to the operation of the capital markets."[218] The commenter urged the Commission to "provide an affirmative defense for actions taken by a person in accordance with binding contractual rights and obligations under [a security-based swap] . . . or to fulfill a regulatory obligation in connection with [a security-based swap] . . . if the person did not act intentionally or recklessly in connection with such action and . . . complied in good faith with written policies and procedures reasonably designed to meet the obligation."[219] The commenter was concerned that the negligence standard applicable to re-proposed Rules 9j-1(a)(3) and (4), in particular, could lead to potential fraud liability for good faith, non-volitional conduct.[220] Another commenter addressed operational concerns related to the credit markets and argued that the proposed rule would "create considerable uncertainty with respect to the legitimate business decisions of lenders and impair the [security-based swap] market and loan market."[221] The commenter explained that if the rule were to apply to any activity that potentially affects the stream of payments, deliveries or other ongoing obligations or rights between parties to a security-based swap, "each party will have to implement controls and mechanisms to track decisions made in

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217 IIB-ISDA-SIFMA Letter at 5.

218 *Id.* at 8-10.

219 *Id*. at 10-11, 11 n.18 (referencing a safe harbor adopted by the CFTC in connection with non-scienter fraud and manipulative prohibitions as part of its swap dealer business conduct standards).

220 *Id*. at 9. The commenter stated that it did not have the same concerns about proposed Rule 9j-1(b) (now Rule 9j-1(a)(6)), because the scienter standard applicable to that provision is "sufficient to distinguish illegitimate conduct from merely negligent acts that affect payment or delivery obligations."

221 LSTA Letter at 3-10.

connection with each payment, delivery, obligation or right as well as to track changes in its positions in the security-based swap and reference underlying."[222]

The Commission agrees with commenters that an affirmative defense similar to those available under Rule 10b5-1 (when the investment decision is not based on material nonpublic information) is important given the similarity in the antifraud provisions. The Commission also agrees that the affirmative defenses would address concerns regarding market disruption. As a result, the Commission is adopting two affirmative defenses similar in concept to the affirmative defenses in Rule 10b5-1(c).[223] However, the Commission is adapting the affirmative defenses for the specific context of Rule 9j-1. In particular, the Commission is not adopting an affirmative defense that is as broad as the affirmative defenses in Rule 10b5-1(c)(1). Rather, as discussed below, the Commission is limiting the relevant Rule 9j-1 affirmative defense to actions taken pursuant to binding contractual rights under the documentation governing a security-based swap. The Rule 10b5-1(c)(1) affirmative defenses relate to advance planning of purchases or sales pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account, or a written trading plan under certain conditions.[224] Those Rule 10b5-1(c)(1) affirmative defenses were created to "provide appropriate flexibility to those who would like to plan securities transactions in advance, at a time when they are not aware of

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222 *Id.* The LSTA supported the principles underlying section 9(j) but did not see the need for a new rule in light of existing antifraud rules and further believed that the existing antifraud rules would address several of the manufactured credit events described in the 2021 Proposing Release and that the adoption of anti-net short provisions would address other concerns. *Id.* at 3-4. The Commission believes that the affirmative defense provided by new Rule 9j-1(e)(2) will address these concerns.

223 Much of the development of insider trading law has resulted from court cases. The Supreme Court has stated that "[u]nder the 'traditional' or 'classical theory' of insider trading liability, [section] 10(b) and Rule 10b-5 are violated when a corporate insider trades in the securities of his corporation *on the basis of* material, nonpublic information." *O'Hagan*, 521 U.S. at 651-52 (*emphasis added*). *See also* Selective Disclosure and Insider Trading, Exchange Act Release No. 43154 (Aug. 15, 2000), 65 FR 51716, 51727 (Aug. 24, 2000) (discussing the awareness standard required for insider trading liability and adopting the definition of "on the basis" of material nonpublic information in Rule 10b5-1(b)). In this regard, any of the actions set forth in Rule 9j-1(a) with regard to a security-based swap are "on the basis of" material nonpublic information about that security-based swap, the issuer of that security-based swap, or the security underlying that security-based swap, if the person taking the action was aware of the material nonpublic information when the person took the action.

224 *See* Rule 10b5-1(c)(1).

material nonpublic information, and then carry out those pre-planned transactions at a later time, even if they later become aware of material nonpublic information."[225] That flexibility is warranted in the context of corporate insiders and others who periodically come into possession of material nonpublic information but may want to schedule orderly trading of securities of an issuer on a liquid public market. It is not appropriate in the context of security-based swaps, which are typically bespoke, created and issued by the counterparties, and thinly traded.

Accordingly, the Commission is adopting two affirmative defenses to liability under paragraphs (a)(1) through (a)(5) of final Rule 9j-1.

a. Affirmative Defense: Binding Contractual Obligations

First, the Commission is adopting an affirmative defense that maintains the substance of the safe harbor provision in re-proposed Rule 9j-1(f)(1), which would have applied to actions taken pursuant to binding rights and obligations in written documentation governing a security-based swap that was entered into prior to the person coming into possession of material nonpublic information. As adopted, the provision in Rule 9j-1(e)(1) (renumbered from proposed paragraph (f)) is an affirmative defense, rather than a safe harbor, to be consistent with the structure of current Rule 10b5-1(c)(1). The affirmative defense in final Rule 9j-1(e)(1) provides that actions that would otherwise violate the prohibitions of Rule 9j-1(a)(1) through (5) are not a violation "solely for reason of being aware of material nonpublic information" if such actions are "taken by a person in accordance with binding contractual rights and obligations under a security-based swap (as reflected in the written security-based swap documentation governing such transaction or any amendment thereto)."[226] Under this affirmative defense, consistent with Rule 10b5-1(c)(1), a market participant may take action when aware of material nonpublic information but may avoid liability: "so long as the person demonstrates that: (i) [t]he security-

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225 *See* Insider Trading Arrangements and Related Disclosures, Exchange Act Release No. 96492 (Dec. 14, 2022), 87 FR 80362, 80363 (Dec. 29, 2022) ("Rule 10b5-1 Amendments").

226 *See* final Rule 9j-1(e)(1).

based swap was entered into, or the amendment was made, before the person became aware of such material nonpublic information, and (ii) [t]he security-based swap was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of [Rule 9j-1]."[227]

Framing this relief as an affirmative defense rather than as a safe harbor, and restricting its use to circumstances in which the security-based swap was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of the rule, is consistent with Rule 10b5-1(c)(1) treatment of the defense. As discussed above, multiple commenters requested the Commission adopt affirmative defenses based on the Rule 10b5-1(c) defenses.[228] Rule 10b5-1(c)(1) provides an affirmative defense from Rule 10b-5 liability in circumstances where it is apparent that the trading was not made on the basis of material nonpublic information because "the trade was made pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account, or a written plan for the trading of securities . . . adopted at a time that the person was not aware of material nonpublic information."[229] Similarly, Rule 9j-1(e)(1) provides an affirmative defense from Rule 9j-1(a) liability when an action is taken not on basis of material nonpublic information, but pursuant to binding contractual rights and obligations reflected in the written documentation governing a security-based swap.

If the security-based swap was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of the rule, the new Rule 9j-1(e)(1) affirmative defense will allow counterparties to take actions that are required by, and in accordance with, the written agreements governing the security-based swap (*i.e.*, actions in the normal course of the security-based swap transaction) even when aware of material nonpublic information. For example, the

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227 *See* final Rule 9j-1(e)(1).

228 *See supra* note 212.

229 *See* Rule 10b5-1 Amendments, 87 FR 80362, 80363 (adopting revisions to the Rule 10b5-1(c)(1) affirmative defense to apply a cooling-off period on persons other than the issuer of securities subject to a plan, impose a certification requirement on directors and officers of those issuers, limit the ability of persons other than the issuer to use multiple-overlapping Rule 10b5-1 plans, limit the use of single-trade plans by persons other than the issuer to one such single-trade plan in any 12-month period, and add a condition that all persons entering into a Rule 10b5-1 plan must act in good faith with respect to that plan).

Rule 9j-1(e)(1) affirmative defense would apply to making a standardized coupon payment or delivering collateral to a counterparty (and would also permit the counterparty to receive the coupon payment or collateral), while such person is aware of material nonpublic information, so long as both actions are required by the terms of the transaction and documented in writing. In contrast, the affirmative defense would not apply if a counterparty took some action to fraudulently increase (in the case of the receiving counterparty) or decrease (in the case of the delivering counterparty) the amount of such payment or collateral transfer. Rule 9j-1(e) provides an affirmative defense when a person's conduct would violate Rule 9j-1(a)(1) through (5) "solely" because he or she is "aware of material nonpublic information." But actions to fraudulently increase or decrease payments or collateral transfer—when taken in connection with effecting or attempting to effect a transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap—would violate Rule 9j-1(a) regardless of the possession of material nonpublic information.

A person relying on the affirmative defense in adopted final Rule 9j-1(e)(1) must demonstrate that they entered into the security-based swap, or amendment, before becoming "aware of" the material nonpublic information rather than before they "came into possession" of the information, as required in re-proposed Rule 9j-1.[230] The change in the rule text to an awareness standard, rather than a possession standard, brings the Rule 9j-1(e)(1) affirmative defense in line with the Commission's intent, as described in the 2021 Proposing Release preamble.[231] The change also makes Rule 9j-1(e)(1) consistent with Rule 10b5-1(c)(1), which requires that the person entered into a binding contract before becoming "aware of" the material nonpublic information.[232]

b. Affirmative Defense: Policies and Procedures

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230 *See* 2021 Proposing Release, 87 FR at 6703.

231 *See* 2021 Proposing Release, 87 FR at 6662.

232 *See* 17 CFR 240.10b5-1(c)(1)(i)(A).

Second, Rule 9j-1(e)(2) provides a defense from liability under Rules 9j-1(a)(1) through (5) for actions taken by a person, other than a natural person, who demonstrates that: (1) the individual making the investment decision on behalf of the person was not aware of the material nonpublic information; and (2) the person had implemented reasonable policies and procedures, taking into consideration the nature of the person's business, to ensure that individuals making investment decisions would not be in violation of Rule 9j-1(a)(1) through (5).[233] These policies and procedures may include those that restrict an individual from effecting a transaction in, or purchasing or selling, any security, including any security-based swap, as to which the individual possesses material nonpublic information, or those that prevent individuals from becoming aware of such information.[234] Rule 9j-1(e)(2) is modeled on Rule 10b5-1(c)(2) and addresses concerns raised by commenters that the proposed rule would have a chilling effect on the markets. Rule 9j-1(e)(2) recognizes that many market participants, such as lenders and life insurance companies, employ compliance programs which include, among other things, information barriers that prevent access to material nonpublic information by their employees who engage in security-based swap transactions for hedging or other purposes.

c. Proposed Safe Harbor: Compression

Because the Commission is adopting final Rule 9j-1(e)(2), the Commission is not adopting proposed Rule 9j-1(f)(2), which would have provided a safe harbor for transactions made in connection with certain portfolio compression exercises. The proposed safe harbor would have conflicted with Rules 10b-5 and 10b5-1 by providing the same action with protection from liability under Rule 9j-1, but not Rule 10b-5. In proposing the portfolio compression safe harbor, the Commission recognized the benefits provided by portfolio compression along with the "largely administrative nature of the portfolio compression process."[235] To be clear, the

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233 Final Rule 9j-1(e)(2).

234 *See* final Rule 9j-1(e)(2)(ii).

235 2021 Proposing Release, 87 FR at 6662-63 (describing the operational benefits and efficiencies resulting from portfolio compression).

Commission continues to support portfolio compression and its benefits.[236] Providing the safe harbor as proposed, however, would have sanctioned *the use* of material nonpublic information under Rule 9j-1, even though that use would have been prohibited by Rule 10b-5. Adopting Rule 9j-1(e)(2) instead will avoid confusion that could have resulted by treating the same conduct differently under Rules 10b-5 and 9j-1. In addition, the Rule 9j-1(e)(2) will provide security-based swap market participants the flexibility needed to engage in bilateral and multilateral portfolio compression exercises. The affirmative defense should be consistent with the manner in which Rules 10b-5 and 10b5-1(c)(2) currently apply to compression exercises and eliminates concerns that compression exercises may be more than merely administrative and could be made on the basis of material nonpublic information.

d. Other Requested Safe Harbors and Affirmative Defenses

Certain commenters were supportive of the proposed safe harbors[237] but also believed that the safe harbors were too narrow and urged the adoption of additional Rule 9j-1 safe harbors for legitimate restructuring transactions, hedging activity related to lending, transactions with counterparty disclosure regarding status as a lender and access to material nonpublic information from the borrower, multilateral amendment exercises (including ISDA protocols) or bilateral equivalents, participation in determinations committee, or for publicly executed strategies.[238] One commenter raised concerns that the proposed safe harbor only addresses situations where a

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236 As the Commission recognized when it adopted portfolio compression requirements for SBS Entities, there are times when entering into compression exercises would not be appropriate. *See* Risk Mitigation Techniques for Uncleared Security-Based Swaps, Exchange Act Release No. 87762 (Dec. 18, 2019), 85 FR 6359, at 6370 (Feb. 4, 2020) ("Risk Mitigation Adopting Release"). As a result, 17 CFR 240.15Fi-4 provides that the policies and procedures required under the rule will need to provide that portfolio compression exercises occur "when appropriate." It would not be appropriate to enter into compression exercises when doing so would be on the basis of material nonpublic information in violation of Commission rules, including Rule 10b-5 or final Rule 9j-1.

237 Only one commenter specifically addressed the compression safe harbor of re-proposed Rule 9j-1(f)(2). *See* IIB-ISDA-SIFMA Letter at 11. The commenter noted that "the important operational benefits and efficiencies for market participants" supporting the safe harbor for portfolio compression exercises would also support a safe harbor for "other centralized market activities" including multilateral amendment exercises (such as an ISDA protocol) and the use of determinations committees. *Id*.

238 *See* Fletcher Letter at 4; IACPM Letter at 4; MFA Letter at 10-12; LSTA Letter at 8-9; IIB-ISDA-SIFMA Letter at 11-12.

lender, aware of material nonpublic information, exercises rights or takes actions with respect to security-based swaps, but not if the lender exercises rights or remedies under a credit, loan, or similar agreement, while aware of material nonpublic information.[239] The Commission declines to adopt additional safe harbors. The affirmative defenses the Commission is adopting provide consistency with Rule 10b5-1. Additionally, they will address concerns expressed by market participants advocating for additional safe harbors by permitting persons to enter into certain types of activity, pursuant to the requirements of the affirmative defenses, while also addressing concerns about fraud and manipulation for the entire security-based swap market.

In response to the proposed safe harbors, one commenter urged for the elimination of all safe harbors from proposed Rule 9j-1(a) liability because the Commission had "not demonstrated that a safe harbor from the prohibition on fraud and manipulation is necessary or appropriate."[240] This same commenter also argued for compliance with Rule 9j-1(a) rather than for the adoption of safe harbors that it believed would encourage unlawful behavior.[241] Another commenter argued that the proposed safe harbors were overly broad and protective of actions that are inherently fraudulent.[242] However, as discussed above, the Commission agrees with commenters that an affirmative defense similar to those available under Rule 10b5-1 (when the investment decision is not based on material nonpublic information) is important given the similarity in the antifraud provisions. The Commission also agrees that the affirmative defenses would address concerns regarding market disruption while also addressing concerns about fraud and

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239 *See* LSTA Letter at 8-9.

240 Better Markets Letter at 9. This commenter stated that it "[d]oes not appear there is any need for a safe harbor such as the one proposed by the SEC, because it is not clear how a prohibition on fraud and manipulation could possibly apply to the performance of completely non-volitional, contractual requirements, of a contract that was entered into without fraudulent, deceptive, or manipulative intent." *Id*. at 10. *See also* WebForm Comments from Anonymous Penguin, dated Oct. 7, 2022 ("Anonymous Penguin Comments"), at 1 (arguing for no affirmative defense from liability); WebForm Comments from J.T., dated Nov. 15, 2022 ("J.T. Comments"), at 1 (arguing for no safe harbor for binding contractual rights and obligations under a security-based swap).

241 Better Markets Letter at 12 (pointing to experience with Rule 10b5-1 and citing studies and Wall Street Journal reporting).

242 *See* WebForm Comments from Michael, dated Jan. 3, 2023 ("Michael Comments"), at 1.

manipulation in the security-based swap market. Therefore, the Commission is adopting the affirmative defenses as discussed above.

In addition to the request for the inclusion of additional safe harbors and affirmative defenses, commenters also addressed the scope of Rule 9j-1 as it applies to different types of security-based swap instruments. One commenter argued for carving out sovereign debt from the scope of Rule 9j-1 due to the unlikelihood that holders of security-based swaps on sovereign debt would be able to manufacture credit events or otherwise engage in opportunistic trading, especially life insurers which are prohibited by state law from entering into speculative or abusive trading.[243] While security-based swaps related to sovereign debt may present fewer opportunities for manufactured credit events or opportunistic strategies, by regulated and non-regulated market participants alike, such instruments are not without risk of fraudulent and manipulative conduct and should remain within the scope of Rule 9j-1.[244] One commenter supported adopting different rules for CDS as opposed to other security-based swaps due to "the structure and nature of CDS instruments," which the commenter believes make CDS more susceptible to opportunistic strategies.[245] However, non-CDS security-based swaps are also susceptible to fraud and manipulation and, therefore, the Commission makes no change to the scope of Rule 9j-1 to treat CDS differently from other security-based swaps. Additionally, Rule 9j-1 is tailored appropriately to address fraud and manipulation for the entire security-based swap market.

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243 *See* ACLI at 3, 13-14 (arguing that sovereign debt should be excluded from the scope of both final Rule 9j-1 and final Rule 10B-1).

244 As of Nov. 25, 2022, sovereign CDS have the second highest gross notional amount outstanding among credit security-based swaps. *See infra* section V.C.2, Table 1. The Commission further observes that the share of CDS written on sovereign debt has risen from less than four percent of the total notional amounts outstanding in the global CDS market in 2007 to 14 percent at the end of 2020. For single-name CDS during that same period, the share of the sovereign sector grew from six percent to close to one-third. *See* Antulio N. Bomfim, "Credit Default Swaps," Finance and Economics Discussion Series 2022-023 at 4, Washington: Board of Governors of the Federal Reserve System (2022), available at https://doi.org/10.17016/FEDS.2022.023. *See also* Ben St. Clair, "Pimco Loses $400m on Failed Russia CDS Bets," Risk.Net (June 20, 2022) (describing the effects on CDS of Russia's failure to pay additional interest due on its sovereign bonds in Apr. 2022).

245 *See* Fletcher Letter at 4.

III. Rule 15fh-4(c): Preventing Undue Influence Over Chief Compliance Officers; Policies and Procedures Regarding Compliance with Rule 9j-1 and Rule 15fh-4(c)

A. Proposed Approach

The Commission also proposed a rule aimed at protecting the independence and objectivity of an SBS Entity's CCO by preventing the personnel of an SBS Entity from taking actions to coerce, mislead, or otherwise interfere with the CCO. Specifically, proposed Rule 15Fh-4(c) ("proposed Rule 15Fh-4(c)") would have made it unlawful for any officer, director, supervised person, or employee of an SBS Entity, or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the SBS Entity's CCO in the performance of their duties under the Federal securities laws or the rules and regulations thereunder.

B. Commission Action

After review of the comments, the Commission is adopting Rule 15fh-4(c) as proposed. The final rule will protect the independence and objectivity of an SBS Entity's CCO by preventing the personnel of an SBS Entity from taking actions to coerce, mislead, or otherwise interfere with the CCO.

The Commission agrees with the two commenters who supported the adoption of Rule 15fh-4(c) to further protect SBS Entities' CCOs from undue influence.[246] Recognizing the CCO's critical function, one commenter believed the new rule would serve as an important deterrent to improper interference with the CCO's duties.[247] A second commenter supported the rule because it would reinforce existing CCO independence requirements and duties essential to effective risk management programs of SBS Entities.[248]

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246 *See* Better Markets Letter at 14; Letter from Patrick T. Campbell, New York City Bar Association, dated Mar. 21, 2022 ("NYC Bar Letter").

247 *See* Better Markets Letter at 14.

248 *See* NYC Bar Letter at 2-5.

One commenter suggested that the proposed rule was unnecessary because the existing requirements of 17 CFR 240.15Fk-1 ("Rule 15Fk-1") are sufficient to address the risks of undue influence on a CCO.[249] This commenter suggested that because the CCO is required to report directly to the board of directors or senior officer of the SBS Entity, and the CCO's compensation and removal requires approval of a majority of the SBS Entity's board of directors, attempts by others to influence the CCO inappropriately should be unavailing.[250] The Commission disagrees. When the Commission previously considered whether to adopt a similar requirement, it concluded that requiring a majority of the board to compensate and remove the CCO was sufficient to establish CCO independence.[251] However, in light of the rules finalized subsequent to the CCO rules, including Rule 9j-1 (which is being adopted in this release) and the risk mitigation requirements for SBS Entities,[252] a rule expressly prohibiting interference with the performance of a CCO's duties is appropriate to: (1) deter any undue influence even if not directly related to compensation or the threat of removal of the CCO; and (2) help ensure the independence and effectiveness of the CCO function.[253] In connection with Rule 9j-1, as well as

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249 *See* Letter from Stephanie Webster, IIB, Chris Young, ISDA, and Kyle Brandon, SIFMA, dated Mar. 21, 2022 ("IIB-ISDA-SIFMA CCO Letter"), at 3.

250 *Id*.

251 The Commission considered and rejected a prohibition on attempts by officers, directors, or employees to coerce, mislead, or otherwise mislead the CCO when it adopted business conduct standards for SBS Entities in 2016. *See* Business Conduct Standards Adopting Release, 81 FR at 30054-55. That rulemaking included, among other things, a rule to require an SBS Entity to designate a CCO and impose certain duties and responsibilities on that CCO, as well as antifraud provisions for SBS Entities. *See* 17 CFR 240.15Fk-1; 240.15Fh-4(a).

252 Risk mitigation rules are designed to further effective risk management by requiring the existence of sound documentation, periodic reconciliation of portfolios, rigorously tested valuation methodologies, and sound collateralization practices. *See* Risk Mitigation Adopting Release, 85 FR at 6390-91.

253 As the Commission explained when adopting similar rules prohibiting persons from unduly influencing auditors pursuant to section 303(a) of the Sarbanes Oxley Act of 2002 ("Sarbanes-Oxley Act), activities by persons acting "under the direction" of officers and directors of the issuer "currently may constitute violations of the anti-fraud or other provisions of the securities laws or aiding or abetting or causing an issuer's violations of the securities laws." Improper Influence on Conduct of Audits, Exchange Act Release No. 47890 (May 20, 2003), 68 FR 31820, 31821 (May 28, 2003) (internal citations omitted). Nevertheless, like the rule implementing section 303(a) of the Sarbanes-Oxley Act, Rule 15fh-4(c) would provide the Commission with an additional means of addressing efforts by persons acting under the direction of an officer or director to thwart the responsibilities of the CCO. *See also* Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Release No. 2204 (Dec. 17, 2003), 68 FR 74714, 74721-22 (Dec. 24, 2003).

other rules for which the CCO is responsible, undue influence could arise from many actors (and many actions), and not merely from those actors with the power to set compensation or with hiring and firing authority over the CCO.[254]

Moreover, existing 17 CFR 240.15Fh-3(h) ("Rule 15Fh-3(h)") requires an SBS Entity to establish and maintain a system to supervise its business and the activities of its associated persons, which must be reasonably designed to prevent violations of the provisions of applicable Federal securities laws and the rules and regulations thereunder.[255] In addition, existing Rule 15Fk-1 requires an SBS Entity to designate a CCO, who must comply with certain duties. Such duties include "[t]ak[ing] reasonable steps to ensure that the [SBS Entity] establishes, maintains and reviews written policies and procedures reasonably designed to achieve compliance with the [Exchange Act] and the rules and regulations thereunder relating to its business as [an SBS Entity]."[256] Failure to establish, maintain, and review written policies and procedures reasonably designed to achieve compliance with the Exchange Act and the rules and regulations thereunder (including Rules 9j-1 and 15fh-4(c)) may result in violations by the SBS Entity of Rule 15Fh-3(h), as well as Rule 15Fk-1.[257] Rule 15fh-4(c) protects investors and promotes the fairness of the markets by supporting the ability of CCOs to meet their important obligations to foster compliance without undue influence, which should ultimately support the integrity of SBS Entities and the markets.

One commenter argued that the scope of proposed Rule 15Fh-4(c) was "unclear and could lead to confusion and uncertainty in the market as to which activities are prohibited."[258]

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254 For example, an employee at an SBS Entity planning an opportunistic strategy could attempt to mislead the CCO by submitting false documentation to the CCO in order to avoid disclosing the build-up of a large position that might require public reporting and thwart the plans of the employee.

255 *See* 17 CFR 240.15Fh-3(h).

256 *See* 17 CFR 240.15Fk-1. Additionally, in its application for registration, an SBS Entity is required to include a senior officer's certification that the SBS Entity has developed and implemented written policies and procedures reasonably designed to prevent violation of Federal securities laws and the rules thereunder. *See* 17 CFR 240.15Fb2-1(b).

257 The SBS Entity could also face liability under 17 CFR 240.15Fb2-1(b) and (h) under such circumstances.

258 IIB-ISDA-SIFMA CCO Letter at 1.

This commenter went on to suggest that, if the Commission did adopt Rule 15fh-4(c), the final rule should clarify which activities are prohibited by including materiality and intent standards that would limit the prohibited interference to knowingly making untrue statements or omitting material facts.[259] The commenter believed that ambiguities could have a chilling effect on communications between the CCO and personnel of the SBS Entity.[260]

After considering the comments, the Commission declines to revise Rule 15fh-4(c) and adopts the rule as proposed. Rule 15fh-4(c) protects the independence and objectivity of an SBS Entity's CCO by prohibiting undue influence by other personnel. The concerns regarding the rule having a chilling effect on communications are misplaced since the rule prohibits actions to coerce, manipulate, mislead, or fraudulently influence CCOs – not good faith disagreements or legitimate discussions. However, such influence could take many forms and is not limited to material misstatements or omissions. As noted, the Commission has adopted the majority of its Title VII rules related to security-based swaps,[261] including rules relating to trading relationship documentation, dispute resolution, portfolio reconciliation, or portfolio compression ("Risk Mitigation Rules"). As the Commission explained when adopting the Risk Mitigation Rules, those rules were designed to further effective risk management by requiring the existence of sound documentation, periodic reconciliation of portfolios, rigorously tested valuation methodologies, and sound collateralization practices.[262] Attempts by officers, directors, or employees to hide transactions, submit false valuations, or manipulate or fraudulently influence the CCO in the performance of their duties related to the Risk Mitigation Rules would undermine the SBS Entity's risk management and could pose risk to the market. Therefore, the Commission

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259 *See id.* at 2 (stating that the rule is unclear and could lead to confusion and uncertainty in the market as to which activities are prohibited and that the rule does not provide any materiality or intent standards, which could allow for immaterial or inadvertent actions or statements to result in liability).

260 *Id.* IIB-ISDA-SIFMA was concerned that questions could arise as to whether good faith disagreements or legitimate discussions "involve[d] 'interference' with or 'undue influence' over a CCO." *Id.*

261 *See supra* note 16.

262 *See* Risk Mitigation Adopting Release, 85 FR at 6390-91.

is adopting a rule that is broad enough to apply to these actions and any others that may undermine the independence and responsibilities of the CCO.

A commenter also argued for more clarity with regard to the intent and conduct required to be liable under Rule 15fh-4(c).[263] The Commission declines to make any revisions to the proposed rule in response to this comment. Specifically, the acts to "coerce, manipulate, mislead, or fraudulently influence" that would be prohibited by Rule 15fh-4(c) imply compelling the CCO to act in a certain way through pressure, threats, trickery, intimidation, misrepresentation, or some other form of purposeful action not limited to untrue statements or omissions of material facts, and therefore, further clarity is not necessary.[264] As noted, one of the purposes of Title VII security-based swap legislation is promoting the integrity of the security-based swap market. Such a purpose would not be served by imposing a scienter or materiality requirement on Rule 15fh-4(c) violations. Further, the Commission believes that the rule will encourage directors, officers, supervised persons, or employees of SBS Entities to exercise reasonable attention and care in their dealings with CCOs.

One commenter suggested expanding the scope of the rule to actions taken to coerce, manipulate, mislead, or fraudulently influence all officers and other decision-makers, and not limit the rule to actions taken with respect to the SBS Entity's CCO.[265] However, activities taken by persons under the direction of officers and directors of an issuer may already constitute violations of the securities laws.[266] This additional rule is appropriate given the key role that the CCO plays in an SBS Entity's compliance with the security-based swap related regulations, such as the risk mitigation requirements for SBS Entities. Furthermore, it provides an additional

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263 *See* IIB-ISDA-SIFMA CCO Letter at 2.

264 The Commission came to a similar conclusion when adopting similar rules prohibiting persons from unduly influencing auditors pursuant to section 303(a) of the Sarbanes Oxley Act of 2002 ("Sarbanes-Oxley Act). *See* Improper Influence on Conduct of Audits, Exchange Act Release No. 47890 (May 20, 2003), 68 FR 31820, 31823 (May 28, 2003).

265 Michael Comments at 1.

266 *See supra* note 252.

means of addressing efforts by persons acting under the direction of an officer or director to thwart the responsibilities of the CCO.

IV. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA")[267] imposes certain requirements on Federal agencies in connection with the conducting or sponsoring of any "collection of information."[268] Neither Rule 9j-1 nor Rule 15fh-4(c) contain a collection of information requirement within the meaning of the PRA. Specifically, Rule 9j-1 contains prohibitions designed to prevent fraud, manipulation, and deception in connection with effecting transactions in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap. Rule 15fh-4(c) generally makes it unlawful for certain specified persons to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence an SBS Entity's CCO in the performance of their duties under the Federal securities laws or the rules and regulations thereunder. Neither of those rules require a person to establish, maintain, and enforce written policies and procedures reasonably designed to ensure compliance with the applicable rule. However, to the extent that a person is already subject to a similar policies and procedures requirement, any updates to those policies and procedures would likely be captured by an existing collection of information. For example, as previously explained, Rule 15Fh-3(h) requires an SBS Entity to establish and maintain a system to supervise its business and the activities of its associated persons and that system must be reasonably designed to prevent violations of the provisions of applicable Federal securities laws and the rules and regulations thereunder. In the PRA analysis when that rule was adopted, the Commission estimated that each SBS Entity would spend 60 hours per year to update each of the policies and procedures required by Rule 15Fh-3.[269] Both Rule 9j-1 and Rule 15fh-4(c) are intended solely to identify actions that

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267 44 U.S.C. 3501 *et seq*.

268 *See* 44 U.S.C. 3502(3).

269 *See* Business Conduct Standards Adopting Release, 81 FR at 30094.

an SBS Entity is not permitted to take, and as such do not make substantive modifications to any existing collection of information or impose new information collection requirements within the meaning of the PRA. Accordingly, we are not revising any burden and cost estimates in connection with these amendments.

V. Economic Analysis

A. Introduction

The Commission is mindful of the economic effects, including the costs and benefits, of Rule 9j-1 and Rule 15fh-4(c). Section 3(f) of the Exchange Act[270] directs the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. In addition, section 23(a)(2) of the Exchange Act[271] requires the Commission, when making rules under the Exchange Act, to consider the impact that the rules would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The analysis below addresses the likely economic effects of Rule 9j-1 and Rule 15fh-4(c), including the anticipated benefits and costs of the rules and their likely effects on efficiency, competition, and capital formation. Many of the benefits and costs discussed below are difficult to quantify. For example, the Commission cannot quantify the impact of litigation and litigation risk on counterparties and underlying entities or the overall impact on the credibility and reputation of the security-based swap market. The extent of some of these impacts will depend, in part, on events difficult to predict that might affect security-based swaps, such as changes in counterparty or reference underlying entity behavior. Reputational and credibility effects also are difficult to measure. Therefore, while the Commission attempted to quantify

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270 15 U.S.C. 78c(f).

271 15 U.S.C. 78w(a)(2).

economic effects where possible, much of the discussion of the anticipated economic effects below is qualitative and descriptive in nature.

The Commission received a number of comments related to various aspects of the economic analysis of re-proposed Rule 9j-1 and proposed Rule 15Fh-4(c). The Commission has considered and responded to these comments in the sections that follow.

B. Broad Economic Considerations

This section discusses certain aspects of the security-based swap market that may raise concerns or may be associated with concerns that would be addressed by final Rule 9j-1. The discussion is illustrative and is not intended to exhaust all types of conduct that may implicate final Rule 9j-1.

Opportunistic Strategies

Opportunistic strategies often involve CDS buyers or sellers taking steps, either with or without the participation of the underlying entity, to avoid, trigger, delay, accelerate, decrease, and/or increase payouts on CDS.[272] When market participants employ one of these strategies, they intend to obtain gains from the positions they hold that go beyond those corresponding to the initial profit and loss expectation (the initial payoff function) at trade execution. This additional gain would be obtained to the direct detriment of a counterparty that is unaware of that additional loss potential.[273] One commenter pointed out that while CDS have many privately and socially valuable uses, such instruments could lend themselves to abuses such as opportunistic strategies.[274]

To the extent that market participants anticipate opportunistic strategies, the CDS spread or price becomes a reflection of the likelihood of an opportunistic strategy being announced (or,

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272 *See supra* note 35 and accompanying text for a discussion of the settlement process that determines payout on a CDS contract that relies on the ISDA standard documentation.

273 The market participant's gain from the transaction is inversely proportional to the gain of the counterparty, so the larger the market participant's position (and gain), the larger the counterparty's loss.

274 Letter from Henry T.C. Hu, dated Mar. 21, 2022, at 6.

if already announced, of succeeding) and decouples from the credit fundamentals of the reference entity.[275] This effect reduces the utility of the CDS market as a venue to offload or take on the credit risk of a company because prices no longer reflect credit risk; bona fide hedgers or speculators in this market would be more likely to exit, as they cannot readily "trade" the credit of a company.[276] In addition to their adverse impact on price efficiency, opportunistic strategies may impair the liquidity of the CDS markets. The fact that a counterparty might manufacture or delay a credit event in the future can deter others from entering into such contracts. If fewer parties enter into CDS contracts, the overall value of CDS as a risk-transferring instrument for the market will be reduced.[277] Two commenters suggested that lenders may demand a higher rate of return (cost of debt) on new debt issuances by a reference entity that was involved in a manufactured credit event to compensate for the risk that such manufactured events may recur in the future.[278]

C. Baseline

1. Existing Regulatory Frameworks

As discussed in section I.A, because security-based swaps are included in the Exchange Act's definition of "security," participants in the security-based swap market are currently subject to the general antifraud and anti-manipulation provisions of the Federal securities laws, including sections 9(a) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and section 17(a) of the Securities Act. In particular, Rule 10b5-1 provides that a person trades "on the basis of" material nonpublic information when the person purchases or sells securities while aware of

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275 Two commenters noted that opportunistic strategies impede price efficiency in the CDS market, particularly the CDS of distressed issuers because such strategies can be more profitable when implemented on distressed issuers. *See* AFRED Letter at 4-5; Fletcher Letter at 3.

276 *See* Gina-Gail S. Fletcher, *Engineered Credit Default Swaps: Innovative or Manipulative?*, 94 N.Y.U. L. REV. 1073 (2019) (explaining that "engineered" or "manufactured" transactions distort the information reflected in CDS spreads, to the point where the default risk expressed in CDS spreads is no longer connected to the financial condition of the underlying entity).

277 *See* Fletcher Letter at 3.

278 *See* AFRED Letter at 4; Fletcher Letter at 3.

the information. However, the rule also sets forth several affirmative defenses to permit persons to trade in certain circumstances where it is clear that the information was not a factor in the decision to trade.[279] Several commenters pointed out that most security-based market participants have organized their business activities and implemented policies and procedures to allow them to rely on the affirmative defense provided by Rule 10b5-1(c)(2) from liability under Rule 10b-5.[280]

In addition, the Dodd-Frank Act expanded the anti-manipulation provisions of section 9 of the Exchange Act to encompass security-based swap transactions and required the Commission to adopt rules to prevent fraud, manipulation, and deception in connection with security-based swaps.[281] The Commission has now finalized a majority of its Title VII rules related to SBS Entities, including rules that allow such persons to manage the market, counterparty, operational, and legal risks associated with their security-based swap business. These include the Risk Mitigation Rules;[282] rules relating to capital, margin, and segregation requirements for SBSDs, MSBSPs, and broker-dealers;[283] and rules relating to recordkeeping and reporting requirements for SBSDs, MSBSPs, and broker-dealers.[284] These rules are discussed in the 2021 Proposing Release.[285] As discussed earlier, the CFTC has largely

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279 *See* Selective Disclosure and Insider Trading, Exchange Act Release No. 43154 (Aug. 15, 2000), 65 FR 51716 (Aug. 24, 2000).

280 *See* IACPM Letter at 4; IIB-ISDA-SIFMA Letter at 4-5; MFA Letter at 13; SIFMA AMG Letter at 11. *See also supra* section II.E.2. EBF supports the arguments in the IIB-ISDA-SIFMA Letter regarding proposed Rule 9j-1. *See* Letter from EBF at 1; *supra* note 124.

281 *See supra* note 4 and accompanying text.

282 *See supra* section III.B and note 262.

283 *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, Exchange Act Release No. 86175 (June 21, 2019), 84 FR 43872 (Aug. 22, 2019).

284 *See* Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers, Exchange Act Release No. 87005 (Sep. 19, 2019), 84 FR 68550 (Dec. 16, 2019).

285 *See* 2021 Proposing Release, 87 FR at 6681-82.

completed its Title VII rulemakings related to swaps, including the adoption of antifraud and anti-manipulation rules.[286]

Finally, Rule 15Fk-1 requires an SBS Entity to designate a CCO and imposes certain duties and responsibilities on that CCO.[287] Additionally, the rule requires that a majority of the board approve the compensation and removal of the CCO.[288] Rule 15Fh-4(a) makes it unlawful for an SBS Entity to: (1) employ any device, scheme, or artifice to defraud any special entity or prospective customer who is a special entity; (2) engage in any transaction, practice, or course of business that operates as a fraud or deceit on any special entity or prospective customer who is a special entity; or (3) engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative.[289] Further, existing Rule 15Fh-3(h) requires an SBS Entity to establish and maintain a system to supervise its business and the activities of its associated persons; the system must be reasonably designed to prevent violations of the provisions of applicable Federal securities laws and the rules and regulations thereunder.[290]

2. Security-Based Swap Data, Market Participants, Dealing Structures, and Levels of Security-Based Swap Trading Activity

As of January 4, 2023, there were 50 entities registered with the Commission as SBSDs, and no entities registered as MSBSPs.[291] Market participants such as SBSDs and MSBSPs were required to report security-based swap transactions to registered security-based swap data repositories ("SBSDRs") pursuant to Regulation SBSR beginning on November 8, 2021.

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286 *See supra* note 16.

287 *See* 17 CFR 240.15Fk-1(a) through (c).

288 *See* 17 CFR 240.15Fk-1(d).

289 *See* 17 CFR 240.15Fh-4(a).

290 *See* 17 CFR 240.15Fh-3(h).

291 *See* List of Registered Security-Based Swap Dealers and Major Security-Based Swap Participants, available at https://www.sec.gov/files/list_of_sbsds_msbsps_1_4_2023locked_final.xlsx (providing the list of registered SBSDs and MSBSPs that was updated as of Jan. 4, 2023).

The Commission uses information reported pursuant to Regulation SBSR to two registered SBSDRs – Depository Trust & Clearing Corporation Data Repository ("DDR") and the ICE Trade Vault ("ITV") – to describe the baseline.[292] Table 1 shows that U.S. security-based swap market activity is split across three asset classes: credit, equity, and interest rate. Based on information reported to DDR, as of November 25, 2022, there were approximately 523,000, 3.4 million, and 5,700 active security-based swaps in the credit, equity, and interest rate asset classes, respectively. The gross notional amounts outstanding in the credit, equity, and interest rate asset classes were respectively, approximately $2.8, $3.6, and $0.18 trillion.[293] Based on information reported to ITV, as of November 25, 2022, there were approximately 155,000 active credit security-based swaps with gross notional amount outstanding of approximately $1.9 trillion.

Table 1 also shows that U.S. security-based swap market participants trade a variety of security-based swaps in each of the three asset classes. Based on information reported to DDR, as of November 25, 2022, active credit security-based swaps fall into five product types. Single-name corporate CDS constitute the largest product type, with approximately 364,000 active CDS and $1.6 trillion gross notional amount outstanding. The second largest active credit security-

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[292] DDR operates as a registered SBSDR for security-based swap transactions in the credit, equity, and interest rate derivatives asset classes. ITV operates as a registered SBSDR for security-based swap transactions in the credit derivatives asset class. *See* Security-Based Swap Data Repositories; DTCC Data Repository (U.S.) LLC; Order Approving Application for Registration as a Security-Based Swap Data Repository, Exchange Act Release No. 91798 (May 7, 2021), 86 FR 26115 (May 12, 2021); Security-Based Swap Data Repositories; ICE Trade Vault, LLC; Order Approving Application for Registration as a Security-Based Swap Data Repository, Exchange Act Release No. 92189 (June 16, 2021), 86 FR 32703 (June 22, 2021). The statistics presented herein are based on the SBS Report. *See supra* note 42.

[293] Active security-based swaps are those that have been neither terminated nor reached their scheduled maturity and are therefore open positions as of Nov. 25, 2022. Gross notional amount outstanding represents the total outstanding notional value of active, market-facing security-based swaps on Nov. 25, 2022. Security-based swaps are considered to be "market-facing" when they are executed at arms-length between third parties. While a reporting party is only required to report a transaction to one SBSDR – either DDR or ITV – some uncleared security-based swaps in DDR also appear in ITV. This overlap is very limited in scope. As of Nov. 25, 2022, there were 605 active credit security-based swaps in ITV that were reported as uncleared (0.4% of the 154,903 active credit security-based swaps in ITV). The 605 active credit security-based swaps had a gross notional outstanding of $4.73 billion (0.3% of the approximately $1,900 billion gross notional outstanding of all active credit security-based swaps in ITV). These statistics provide an upper bound of the overlap between ITV and DDR and indicate that the overlap is very limited in scope. *See* SBS Report at 4 and 10.

based swaps product type consists of single-name sovereign CDS, with approximately 94,000 active CDS and $0.9 trillion gross notional amount outstanding. For active equity security-based swaps, equity portfolio swaps constitute the largest product type, with approximately 2.3 million active equity portfolio swaps and $1.7 trillion gross notional amount outstanding. The second largest active equity security-based swaps product type consists of equity swaps, with approximately 492,000 active equity swaps and $1.2 trillion gross notional amount outstanding. Equity portfolio swaps and equity swaps can be further divided into sub-products that include, among other things, equity TRS.[294] In the interest rate asset class, exotics constitute the largest product type, with approximately $0.1 trillion gross notional amount and 4,400 active exotic swaps outstanding. Based on information reported to ITV, as of November 25, 2022, active credit security-based swaps fall into two product types. Single-name corporate CDS constitute the largest product type, with approximately 135,000 active CDS and $1.3 trillion gross notional amount outstanding. The second largest active credit security-based swaps product type consists of single-name sovereign CDS, with approximately 20,000 active CDS and $0.5 trillion gross notional amount outstanding.

Table 1. Gross notional amount and active security-based swaps outstanding on Nov. 25, 2022, categorized by asset class and product classification.[a]

SBSDR	Asset Class	Product Type	Gross Notional Amount Outstanding (Millions of USD)	Active Security-Based Swap Count
DDR	Credit	Index	44,407	2,992
		Single-Name: Corporate	1,556,315	364,465
		Single-Name: Sovereign	900,072	93,807
		TRS[b]	156,849	49,867
		Other[c]	122,970	12,081
		Total	2,780,613	523,212
	Equity	Portfolio Swap	1,688,672	2,266,706
		Swap	1,183,279	491,508
		Contract For Difference	398,952	642,965
		Option	6,915	1,281

294 An equity swap references a single underlier while an equity portfolio swap involves a portfolio wrapper under which multiple swaps can be traded with operational efficiency. *See Central Clearing in the Equity Derivatives Market: An ISDA Study*, ISDA.ORG (June 2014) at 10, available at https://www.isda.org/a/6PDDE/central-clearing-in-the-eqd-market-final.pdf. *See* ISDA, ISDA Taxonomy 2.0 – Finalized, ISDA.org (Sep. 4, 2019), available at https://www.isda.org/a/o1MTE/ISDA-Taxonomy_EQ-CR-FX-IR_v2.0__3-_September_2019-FINAL.xls (indicating that equity portfolio swaps and equity swaps can be further divided into sub-products that include, among other things, equity TRS).

		Forward	5,663	1,393
		Other[d]	330,136	41,115
		Total	3,613,617	3,444,968
	Interest Rate	Exotic	153,306	4,419
		Forward	23,818	1,164
		Other[e]	868	122
		Total	177,992	5,705
ITV	Credit	Single-Name: Corporate	1,348,002	134,741
		Single-Name: Sovereign	544,414	20,162
		Total	1,892,416	154,903

[a] For cleared security-based swaps in DDR, this table incorporates only one of the two security-based swaps that result from the clearing process. For ITV, this table incorporates all of the cleared security-based swaps.
[b] As a general matter, TRS include non-CDS debt-based security swaps, equity-based security swaps, and mixed swaps. Counterparties in the TRS market use the contracts to obtain exposure, usually leveraged, to the total economic performance of a security or index and benefit from not having to own the security itself. Market participants, such as mutual funds, hedge funds, and endowments, use TRS to obtain exposure in markets where they would face difficulties purchasing or selling the underlying security (*e.g.,* a market participant may find it difficult to buy a foreign company's security or locate a security to sell short) while taking advantage of the capital efficiencies of not holding the security in their inventories. *See also supra* section I.B.1, which discusses the ongoing payment stream of TRS, among other things.
[c] Includes the following products reported to SBSDRs: exotic, index tranche, swaptions, and other single-name (*e.g.*, asset-backed, loan, and municipal security-based swaps).
[d] "Other" is a category in the DDR Equity Product ID field. All Product ID categories are listed in the table.
[e] Includes the following products reported to SBSDRs: inflation, debt option, and cross-currency.

Table 2 shows that both SBS Entities and non-SBS Entities participate in all three asset classes in the U.S. security-based swap market. Based on information reported to DDR, as of November 25, 2022, SBS Entities and non-SBS Entities had, respectively, entered into approximately 813,000 and 234,000 active credit security-based swaps.[295] The gross notional amounts outstanding of the active credit security-based swaps held by SBS Entities and non-SBS Entities were, respectively, approximately $4.4 and $1.2 trillion. In the equity asset class, SBS Entities and non-SBS Entities had, respectively, entered into approximately 4.0 million and 2.9 million active equity security-based swaps. The gross notional amounts outstanding of the active equity security-based swaps held by SBS Entities and non-SBS Entities were, respectively, approximately $4.5 and $2.7 trillion. In the interest rate asset class, SBS Entities and non-SBS

[295] For cleared security-based swaps where at least one counterparty is an SBS Entity, Table 2 reflects the security-based swaps entered into by each of the original counterparties, but does not include the positions of the clearing organizations themselves. For uncleared security-based swaps, Table 2 reflects the security-based swaps entered into by each of the original counterparties. *See* SBS Report at 5.

Entities had, respectively, entered into approximately 6,200 and 5,200 active interest rate security-based swaps. The gross notional amounts outstanding of the active interest rate security-based swaps held by SBS Entities and non-SBS Entities were, respectively, approximately $0.2 and $0.1 trillion. Based on information reported to ITV, as of November 25, 2022, SBS Entities and non-SBS Entities had, respectively, entered into approximately 123,000 and 33,000 active credit security-based swaps. The gross notional amounts outstanding of the active credit security-based swaps held by SBS Entities and non-SBS Entities were, respectively, approximately $1.6 and $0.3 trillion.

Table 2. Gross notional amount and active security-based swaps outstanding on Nov. 25, 2022, categorized by asset class and registrant type.[a]

SBSDR	Asset Class	Registrant Type	Gross Notional Amount Outstanding (Millions of USD)	Active Security-Based Swap Count
DDR	Credit	Total	5,561,226	1,046,424
		SBS Entities	4,403,130	812,647
		Other	1,158,096	233,777
	Equity	Total	7,227,234	6,889,936
		SBS Entities	4,490,592	4,013,393
		Other	2,736,642	2,876,543
	Interest Rate	Total	355,984	11,410
		SBS Entities	210,663	6,214
		Other	145,321	5,196
ITV	Credit	Total	1,897,249	155,578
		SBS Entities	1,632,251	122,831
		Other	264,998	32,747

[a] For cleared security-based swaps where at least one counterparty is an SBS Entity, Table 2 reflects the security-based swaps entered into by each of the original counterparties, but does not include the positions of the clearing organizations themselves. For uncleared security-based swaps, Table 2 reflects the security-based swaps entered into by each of the original counterparties.

In addition to information reported to registered SBSDRs, the Commission also uses data from the DTCC Derivatives Repository Limited Trade Information Warehouse ("DTCC-TIW") to describe the baseline. DTCC-TIW provides data regarding the activity of market participants

in the single-name CDS market during the period from 2006 to the end of 2021.[296] The Commission acknowledges that limitations in the data constrain the extent to which it is possible to quantitatively characterize the security-based swap market.[297] Based on an analysis of DTCC-TIW data, staff concluded that there are 2,326 transacting agents that engaged directly in trading between November 2006 and December 2021 with 15,721 accounts.[298]

Data from the DTCC-TIW show that activity in the single-name CDS market is concentrated among a relatively small number of entities, predominantly registered SBSDs.[299] The top two SBSDs (when accounts are sorted by number of counterparties) each transacted with over a thousand counterparty accounts, consisting of both other SBSDs and non-SBSDs. The next 13 percent of SBSDs each transacted with 500 to 1,000 counterparty accounts; the

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296 DTCC-TIW provides weekly positions and monthly transaction files on a voluntary basis for single-name and index-based CDS. These data cover all positions and transactions where one of the counterparties is a U.S. entity or the reference entity is a U.S. entity, with status as a U.S. entity determined by DTCC-TIW. In DTCC-TIW, the Commission observes end of week CDS positions for all U.S. entities, foreign counterparties to a U.S. entity, or foreign counterparties trading a CDS referencing a U.S. underlying entity. The DTCC-TIW data have limitations. The data do not address two foreign counterparties with CDS referencing foreign underlying entities. In addition, the DTCC-TIW data do not provide any intra-weekly CDS position information, nor any information on the underlying security holdings of reference entities. Further, DTCC-TIW is a voluntary database where market participants on a voluntary basis submit transactions and end of week holdings.

297 The Commission also relies on qualitative information regarding market structure and evolving market practices provided by commenters and the knowledge and expertise of Commission staff.

298 These 2,326 entities, which are presented in more detail in Table 3, below, include all DTCC-TIW-defined "firms" shown in DTCC-TIW as transaction counterparties that report at least one transaction to DTCC-TIW as of Dec. 2021. The staff in the Division of Economic and Risk Analysis classified these firms by machine-matching names to known third-party databases and by manual classification. *See, e.g.*, Security-Based Swap Transactions Connected with a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed By Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception, Exchange Act Release No. 77104 (Feb. 10, 2016), 81 FR 8598, 8602 n.43 (Feb. 19, 2016). Manual classification was based in part on searches of the EDGAR and Bloomberg databases, the SEC's Investment Adviser Public Disclosure database, and a firm's public website or the public website of the account represented by a firm. As mentioned above, data on CDS market participants come from DTCC-TIW. Principal holders of CDS risk exposure are represented by "accounts" in the DTCC-TIW. "Accounts" as defined in the DTCC-TIW context are not equivalent to "accounts" in the definition of "U.S. person" provided by Exchange Act Rule 3a71-3(a)(4)(i)(C). 17 CFR 3a71-3(a)(4)(i)(C). One entity or legal person (known as "transacting agent" in the terminology of DTCC-TIW) may have multiple accounts. For example, a bank that is a transacting agent may have one DTCC-TIW account for its U.S. headquarters and one DTCC-TIW account for one of its foreign branches.

299 Dealers are generally persons engaged in the business of buying and selling securities for their own account, through a broker or otherwise. 15 U.S.C. 78c(a)(5). SBSDs are generally defined as persons who hold themselves out as dealers in security-based swaps; make markets in security-based swaps; regularly enter into security-based swaps as an ordinary course of business for their own account; or engage in any activity causing them to be commonly known in the trade as a dealer or market maker in security-based swaps. 17 CFR 240.3a71-1.

following 21 percent of SBSDs each transacted with 100 to 500 counterparty accounts; and 62 percent of SBSDs each transacted security-based swaps with fewer than 100 counterparty accounts in 2021. The median number of counterparty accounts across SBSDs is 16 (the mean is approximately 191). SBSD-intermediated transactions reached a gross notional amount of approximately $1.5 trillion, approximately 66 percent of which was intermediated by the top five SBSD accounts. The median non-dealer counterparty transacted with only one SBSD account (with an average of approximately 1.9 SBSD accounts) in 2021.

Non-dealer single-name CDS market participants include, but are not limited to, investment companies, pension funds, private funds, sovereign entities, and industrial companies. We observe that most non-dealer market participants of single-name CDS do not engage directly in the trading of security-based swaps, but trade through banks, investment advisers or funds, or other types of firms, which we refer to as transacting agents, consistent with DTCC-TIW terminology.[300] As shown in Table 3, close to 79 percent of transacting agents are identified as investment advisers or funds.[301] Although investment advisers and funds are the vast majority of transacting agents, the transactions they executed account for only about 15 percent of all single-name CDS trading activity reported to the DTCC-TIW, measured by the number of transaction sides.[302] The vast majority of transactions, approximately 82 percent, measured by number of transaction-sides were executed by ISDA-recognized dealers.

Table 3. The number of transacting agents by counterparty type and the fraction of total trading activity, from Nov. 2006 through Dec. 2021, represented by each counterparty type.

Transacting Agents	Number	Percent	Transaction share
Investment Advisers/Funds[a]	1,858	78.7%	14.6%
Banks (excluding G16)[b]	278	11.8%	3.3%
Pension Funds	30	1.3%	0.1%

300 Transacting agents participate directly in the security-based swap market, without relying on an intermediary, on behalf of their principals, investment companies, pension funds, private funds, sovereign entities, and industrial companies. For example, a university endowment may hold a position in a security-based swap that is established by an investment adviser that transacts on the endowment's behalf. In this case, the university endowment is a principal that uses the investment adviser as its transacting agent.

301 DTCC-defined "firms" shown in DTCC-TIW, which we refer to here as "transacting agents."

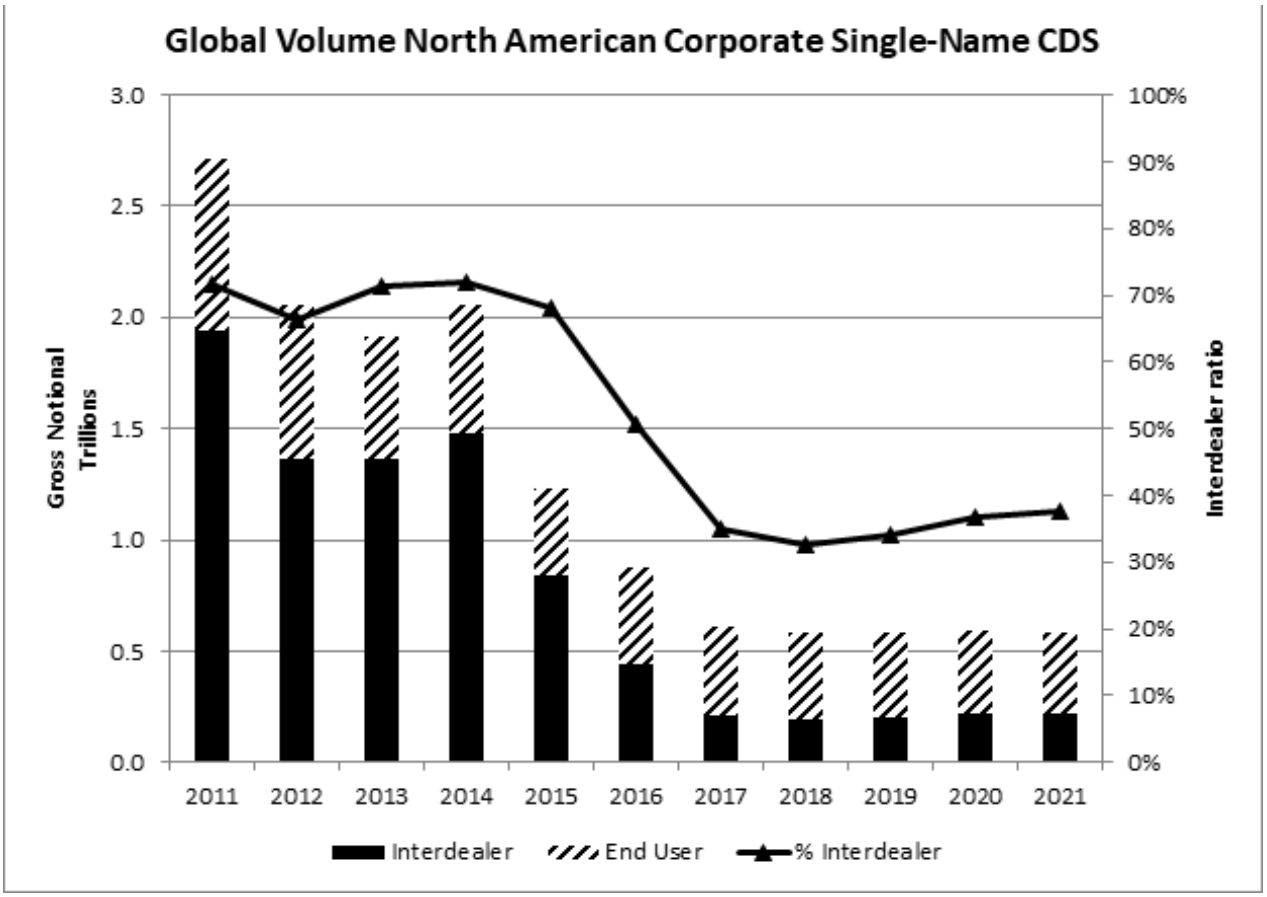
302 Each transaction has two transaction sides, *i.e.*, two transaction counterparties.

Insurance Companies	49	2.1%	0.2%
ISDA-Recognized Dealers[c]	17	0.7%	81.6%
Other	130	5.5%	0.2%
Total	2,362	100.0%	100%

[a] Investment Adviser/Funds – For purposes of this table, these entities have the following characteristics: clients are predominantly individuals, institutions, and investment companies that take public and institutional money. Some also manage pooled investment vehicles (*e.g.*, hedge funds), private equity and venture capital.
[b] Banks (excluding G16) – The primary characteristic is the entity is trading for its own account and not just on behalf of its clients. This includes depository institutions, swap dealers (market makers), and classically-defined investment banks.
[c] ISDA recognized dealer – Market makers (dealers) identified by ISDA as belonging to the G14 or G16 dealer group during the period. *See*, *e.g.*, 2010 ISDA Operations Benchmarking Survey (2010), available at https://www.isda.org/a/5eiDE/isda-operations-survey-2010.pdf.

Figure 1 describes the percentage of global, notional transaction volume in North American corporate single-name CDS reported to the DTCC-TIW from January 2011 through December 2021, separated by whether transactions are between two ISDA-recognized dealers (interdealer transactions) or whether a transaction has at least one non-dealer counterparty. Figure 1 also depicts the notional trading volume of all North American corporate single-name CDS. As Figure 1 shows, all types of exposures have declined approximately proportionally since 2011.

Figure 1:



SOURCE: DTCC CDS – TIW. Global, notional trading volume in North American corporate single-name CDS (left axis) by calendar year and the fraction of volume that is interdealer (right axis). Same-day cleared trades are assumed to be either interdealer or between a dealer and an end-user (as security-based swap transactions between two end-users are rare in both the cleared and uncleared markets).

D. Benefits and Costs of Rule 9j-1

1. Benefits

Rule 9j-1 would decrease fraudulent activity and litigation costs, and could decrease compliance costs. In addition, Rule 9j-1 may indirectly increase price efficiency and decrease capital costs of underlying entities. The Commission discusses each of these individual benefits in more detail below.

Rule 9j-1 would reduce the risk of fraud in the security-based swap market, including the risk of opportunistic trading strategies to the extent that such strategies occur in connection with effecting or attempting to effect any transaction in any security-based swap, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap

(including but not limited to, in whole or in part, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security based-swap). The additional specificity offered by Rule 9j-1 may enhance Commission oversight of the security-based swap market, which may ultimately benefit market participants through reducing the risk of fraud. Any reduction in the risk of fraud as a result of Rule 9j-1 would be limited to the extent that the fraudulent, manipulative, and deceptive conduct by security-based swap market participants is currently subject to the general antifraud and anti-manipulation provisions of the Federal securities laws, including but not limited to sections 9(a) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and section 17(a) of the Securities Act. To the extent that Rule 9j-1 reduces the risk of fraud, the rule could encourage participation in the security-based market, which may result in increased competition.[303] More security-based swap entities would be willing to supply (issue) and/or demand (buy) security-based swaps, with increased confidence that their counterparties would have limited abilities to impact the market through fraudulent conduct.

Rule 9j-1 may provide additional precision and specificity regarding the application of existing antifraud and anti-manipulation laws to misconduct in the security-based swap market, which could prompt some market participants to devote greater resources to ensure that they are compliant with their obligations under antifraud and anti-manipulation laws, which could also decrease the risk of fraud in the security-based swap market. Because of this decreased risk of fraud, market participants may have fewer disputes with their counterparties regarding security-based swap contracts, which in turn, could lower litigation costs for security-based swap participants and underlying entities. Lower litigation costs could contribute to reducing the cost of CDS and, to the extent that the cost of CDS is reduced, lower costs of borrowing to the

303 *See* 2019 Joint Statement, *supra* note 53.

underlying entity. Rule 9j-1 may also decrease compliance costs for some market participants who may, as a result of the additional specificity of the rule, need to spend fewer resources determining appropriate compliance under section 9(j).

Decreased risk of fraud in the security-based swap market may also lead to increased price efficiency, as more trading could lead to a greater exchange of market expectations from buyers and sellers transacting in the market. Further, by providing specificity, Rule 9j-1 would help prevent prohibited conduct from distorting the market and artificially increasing or decreasing security-based swap prices, which also would help to ensure more efficient pricing. Increased price efficiency would consequently lead to greater security-based swap market efficiency, as security-based swap prices would provide greater confidence that their prices more likely reflect fundamental values and risk in more liquid markets. For example, the prices of single-name CDS contracts would more likely reflect the fundamental credit risk of the underlying entity, as opposed to counterparty credit risk, or the probability that fraudulent activity prohibited by Rule 9j-1 is being perpetrated in connection with the CDS contracts.[304]

Increased participation and price efficiency in the security-based swap market as a result of Rule 9j-1 could encourage lenders to make greater use of security-based swaps for hedging their loans, which in turn could increase lending activity and capital formation.[305]

In addition, improvements in the security-based swap market as a result of Rule 9j-1 may in turn have a positive impact on capital formation and the cost of capital for the underlying entities. The market participation increases in security-based swaps may enhance liquidity in the underlying market and related swap indices, and, in general, lower the cost of capital for entities referenced by security-based swaps.[306] If single-name CDS prices are more reflective of the

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304 *See generally* Fletcher Letter at 3 (discussing the effects of engineered CDS transactions).

305 *See generally* LSTA Letter at 2 (stating that security-based swaps "play an important in risk management and hedging in the loan markets . . . [and] facilitate lending activity by transferring some or all of the risks associated with lending . . . .").

306 *See* Martin Oehmke & Adam Zawadowski, *Synthetic or Real? The Equilibrium Effects of Credit Default Swaps on Bond Markets*, 28 REV. OF FIN. STUD. 3303–3337 (2015) and Ilhyock Shim & Haibin Zhu, *The*

fundamental credit risk of the underlying entity, as a second order effect, participants in the market for the underlying security would be better informed about the underlying security's attributes through the CDS price signal, likely increasing their willingness to re-enter or engage in the underlying security's market. Specifically, the underlying security market uses the derivative market to assess its quality, as the derivative market in some circumstances is forward looking, liquid, and more informative than the underlying market.[307] Greater activity in the underlying security market due to increased price efficiency and greater availability to hedge these securities in the security-based swap market could lead to lower capital costs and increase capital formation for the underlying entities. To the extent that increased capital formation for the underlying entities is associated with the issuance of a greater variety of securities, investors could benefit because they will have a larger set of investment opportunities with which to meet their investment goals.

Comments received

In the 2021 Proposing Release, the Commission solicited feedback on, among other things, the benefits of the proposed rules, including re-proposed Rule 9j-1.[308] One commenter strongly agreed with the Commission's discussion regarding the beneficial effects of greater participation in the security-based swap markets on liquidity in the underlying market and related swap indices, and the cost of capital for security-based swap referenced entities. The commenter also strongly agreed with the Commission's discussion regarding the value of the derivative market to the underlying security market for assessing the security market's quality.[309]

Impact of CDS trading on the Bond Market: Evidence from Asia, 40 J. OF BANKING & FINANCE 460-475 (2014).

307 *See* Haibin Zhu, *An Empirical Comparison of Credit Spreads Between the Bond Market and the Credit Default Swap Market*, 29 J. OF FIN. SERV. RSCH. 211-235 (2006) and Jongsub Lee, *et al*., *When do CDS Spreads Lead? Rating Events, Private Entities, and Firm-Specific Information Flows*, 130 J. OF FIN. ECON. 556-578 (2018).

308 2021 Proposing Release, 87 FR at 6701-02.

309 Milbank Letter at 10, n.17.

Three commenters believed that re-proposed Rule 9j-1's anticipated benefit of reduced fraudulent and manipulative activity in the security-based swap market would not materialize.[310] Three commenters stated that the adoption of the ISDA Amendments has reduced the use of opportunistic strategies, such as manufactured credit events,[311] while two of these commenters stated that the use of anti-net short provisions in the syndicated bank loan market has also had this effect.[312] One commenter observed that opportunistic strategies have been, on the whole, extremely infrequent and doubted that re-proposed Rule 9j-1 will result in any market-wide benefit from addressing these strategies or significantly reduce manipulative activity in the security-based swap markets.[313] One commenter provided CDS pricing data (in the form of the difference between the CDS spread and underlying cash bond implied credit spread ("CDS-cash basis") and interpreted those data to suggest that CDS protection buyers perceived the risk of certain opportunistic strategies to be low. The commenter then reasoned that because CDS protection buyers perceived the risk of such strategies to be low, re-proposed Rule 9j-1 would not generate the anticipated benefit of reducing fraudulent activity in the security-based swap market as well as encouraging market participation.[314]

The Commission has considered feedback from the commenters who argued that the proposed rule would not have the benefit of reducing fraudulent and manipulative activity in the security-based swap market. The provisions in Rule 9j-1 are designed generally to prohibit a range of fraudulent, manipulative, and deceptive conduct in the security-based swap market. The

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310 *See* LSTA Letter at 4; July 2022 MFA Letter at 4-10; Milbank Letter at 8-9.

311 *Id.*

312 *See* LSTA Letter at 4; July 2022 MFA Letter at 4-10.

313 Milbank Letter at 9.

314 July 2022 MFA Letter at 2-4. The commenter referred to opportunistic strategies undertaken by CDS sellers to affect the likelihood of a credit event and the cost of CDS through actions such as changing the supply of deliverable obligations and offering financing to restructure a reference entity. *See* 2021 Proposing Release, 87 FR at 6655.

rule is not solely intended to address opportunistic strategies in the CDS market.[315] Further, anti-net short provisions and ISDA Amendments are narrowly focused and have limited ability to reduce fraudulent and manipulative activity in the security-based swap market. As discussed in the 2021 Proposing Release, the ISDA Amendments would not address all of the concerns identified in the 2019 Joint Statement, including but not limited to addressing opportunistic strategies that do not involve narrowly tailored credit events.[316] Anti-net short provisions are limited to syndicated bank loans and would not apply to fraudulent activity in the security-based swap market that does not involve such loans. Thus, even if these industry efforts were successful in reducing fraudulent activity, their impact likely would be limited by their narrow scope.

In response to the comment that opportunistic strategies have been, on the whole, extremely infrequent so that re-proposed Rule 9j-1 will not result in any market-wide benefit, the Commission reiterates that the provisions in Rule 9j-1 are designed generally to prohibit a range of fraudulent, manipulative, and deceptive conduct in the security-based swap market. The rule is not solely intended to address opportunistic strategies in the CDS market.[317] Thus, even if opportunistic strategies were no longer implemented, final Rule 9j-1 would benefit the security-based swap market by prohibiting all other types of fraudulent, manipulative, and deceptive conduct in the market. That said, this benefit likely would be limited to the extent that the fraudulent, manipulative, and deceptive conduct by security-based swap market participants is currently subject to the general antifraud and anti-manipulation provisions of the Federal

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315 As discussed earlier in this section, Rule 9j-1 would, among other things, reduce the risk of opportunistic trading strategies to the extent that such strategies occur in connection with effecting or attempting to effect any transaction in any security-based swap, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap (including but not limited to, in whole or in part, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security based-swap).

316 *See* 2021 Proposing Release, 87 FR at 6655 n.31; *supra* note 52.

317 *See supra* note 315.

securities laws, including but not limited to sections 9(a) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and section 17(a) of the Securities Act.

The Commission is not persuaded that the CDS-cash basis data provided by one of the commenters necessarily indicate that CDS protection buyers perceived the risk of certain opportunistic strategies to be low.[318] Apart from such perceived risk, the academic literature suggests a number of factors that affect the CDS-cash basis such as funding cost, counterparty risk, collateral quality, and the CDS reference entity's financial characteristics.[319] Without accounting for the influence of these other factors, it is not clear if the CDS-cash basis reflects that CDS protection buyers perceive the risk of certain opportunistic strategies to be low. Even if the CDS-cash basis data reflect CDS protection buyers' perceived risk of certain opportunistic strategies, the data's limited scope provides no information on the perceived risk of other types of fraudulent and manipulative activity in the security-based swap market. Accordingly, the commenters have not offered convincing evidence that Rule 9j-1 will be without benefits. The Commission continues to believe that Rule 9j-1, by addressing the security-based swap market more broadly, would reduce fraudulent and manipulative activity in this market.

One commenter asserted that proposed Rule 9j-1(b) (adopted as Rule 9j-1(a)(6)) would introduce substantial uncertainty in the application of the antifraud and anti-manipulation provisions of the Federal securities laws, and therefore questioned whether the benefits of "additional precision and specificity" that the Commission identified would materialize.[320] Final Rule 9j-1(a)(6)'s scienter requirements, the practical utility of the rule's objective facts-and-circumstances requirement, and the applicability of familiar case law help mitigate any uncertainty that market participants may have regarding the application of the final rule.

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318 *See* July 2022 MFA Letter at 2-4.

319 *See, e.g.*, Jennie Bai & Pierre Collin-Dufresne, *The CDS-Bond Basis*, 48 FIN. MGMT., 417-439 (2019) and Amrut Nashikkar, *et al*., *Liquidity and Arbitrage in the Market for Credit Risk*, 46 J. OF FIN. QUANTITATIVE ANALYSIS 627-656 (2011).

320 *See* Milbank Letter at 5, 9.

2. Costs

Some security-based swap market participants may incur costs associated with taking actions to update existing compliance systems for compliance with Rule 9j-1. The Commission estimates that security-based swap market participants may incur one-time aggregate costs ranging between $1,225,360 and $2,450,720 to update their existing compliance systems.[321] These additional costs could be limited to the extent that many of these practices and systems are already in place to ensure compliance with section 9(j) of the Exchange Act and the other general antifraud and anti-manipulation statutory and regulatory provisions.

In addition, the rule could discourage some legitimate market activities, including some hedging activity, because of concerns that such activities might be viewed as rule violations. As a result, compliance costs related to evaluating whether or not certain activities are permissible may increase for some market participants.

Market participants might incur costs associated with the affirmative defenses in Rule 9j-1(e). However, such costs likely would be very limited. As a general matter, the affirmative defenses in Rule 9j-1(e) are voluntary and do not impose requirements on market participants.

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321 The Commission estimates that a security-based swap market participant that updates its existing compliance system likely will do so by having a compliance attorney make a one-time update to its policies and procedures. Costs per entity = 1 hour x $424/hour national hourly rate for a compliance attorney = $424. The per-hour figure for a compliance attorney is from SIFMA's Management and Professional Earnings in the Securities Industry—2013, as modified by Commission staff to adjust for inflation (through Dec. 2022) and to account for an 1,800-hour work-year, and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. Based on an analysis of information reported pursuant to Regulation SBSR to DDR and ITV, the Commission estimates that there are 11,559 security-based swap market participants (including SBS Entities) as of Nov. 25, 2022. There is uncertainty as to how many security-based swap market participants will choose to update their existing compliance systems to comply with Rule 9j-1. A lower bound estimate is 25% x 11,559 = 2,889.75, or approximately 2,890 security-based swap market participants. An upper bound estimate is 50% x 11,559 = 5,779.50 or approximately 5,780 security-based swap market participants. The lower bound estimate of one-time aggregate costs = 2,890 x $424 = $1,225,360. The upper bound estimate of one-time aggregate costs = 5,780 x $424 = $2,450,720. There is also uncertainty regarding the specific changes that security-based swap market participants may make to their existing compliance systems to comply with Rule 9j-1. Two commenters believed that re-proposed Rule 9j-1 would require market participants to incur costs to design and implement extensive compliance programs and reconcile the scope of the new rule with existing practices. *See* LSTA Letter at 9-10; IACPM Letter at 4. However, these commenters did not provide quantified estimates of such costs. To the extent that security-based market participants choose to comply with final Rule 9j-1 in the manner described by these commenters, the costs of complying with the final rule could be higher than the Commission's estimate. To the extent that market participants incur compliance costs as a result of Rule 9j-1, these costs represent a reasonable trade-off in light of the benefits discussed in section V.D.1. *See also* discussion later in this section.

Market participants choose to incur costs related to the affirmative defenses if they anticipate the associated benefits to exceed the associated costs. Market participants for whom the anticipated benefits of the affirmative defenses do not exceed the associated costs likely would not incur those costs. However, market participants that choose not to rely on the affirmative defenses may incur other costs (*e.g.*, additional cost of counsel or other experts to evaluate whether actions taken without relying on the affirmative defenses are compliant with the Exchange Act and Commission regulations, and a potential increase in legal liability risk).

Market participants that seek to rely on the affirmative defense in paragraph (e)(1) of Rule 9j-1 likely would do so by creating and retaining the written security-based swap documentation governing such transaction or any amendment thereto. As discussed in the 2021 Proposing Release, such documentation is already created and retained as a result of SBS Entities' compliance with existing 17 CFR 240.15Fi-5 and the Commission's recordkeeping requirements in 17 CFR 240.17a-4 or 17 CFR 240.18a-6, as applicable.[322] Thus, the costs that may be incurred by those market participants that wish to rely on the affirmative defense likely would be very limited, if any.

Market participants that seek to rely on the affirmative defense in paragraph (e)(2) of Rule 9j-1 would be required to comply with the specific provisions of that paragraph, including implementing reasonable policies and procedures to prevent insider trading. For most market participants to whom this affirmative defense would be relevant, the costs associated with policies and procedures likely would be very limited. As discussed above, most security-based swap market participants have spent considerable resources to avail themselves of the affirmative defense of Rule 10b5-1(c)(2).[323] Because the affirmative defense of Rule 9j-1(e)(2) is modeled on that of Rule 10b5-1(c)(2), most security-based swap market participants likely would employ

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322 *See* 2021 Proposing Release 87 FR at 6662 n.88.

323 *See supra* sections II.E.2 and V.C.1.

their existing policies and procedures to avail themselves of the affirmative defenses of both Rules 10b5-1(c)(2) and 9j-1(e)(2).

Comments received

One commenter believed that the proposed rules would help to reduce costs for all investors by removing fraud and manipulation from the security-based swap market and the market for underlying securities.[324] However, several commenters were concerned that re-proposed Rule 9j-1 would significantly increase compliance costs for security-based swap market participants in various ways.

One commenter believed that re-proposed Rule 9j-1 would require market participants to incur costs to design and implement extensive compliance programs to adhere to the rule's broad prohibitions; and that such costs are only marginally alleviated by the narrow proposed safe harbors, since ensuring that each activity falls within a designated safe harbor presents resource challenges of its own. The commenter stated that such compliance costs would be unreasonably burdensome to lenders and would have a significant, negative impact on the loan markets. The commenter also stated that, absent an affirmative defense similar to Rule 10b5-1(c)(2), market participants may have to incur cost and effort to identify all security-based swaps and related reference underlying entities held by the organization and to track and coordinate all activity that could affect the purchase, sale, payments, deliveries, and other ongoing obligations or rights with respect to the security-based swaps and the related reference underlying entities.[325] Another commenter stated that re-proposed Rule 9j-1 would entail further significant costs and challenges because market participants would need to reconcile the scope of the new rule with existing practices.[326]

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324 Michael Comments at 1.

325 LSTA Letter at 9-10.

326 IACPM Letter at 4.

The Commission has considered the above comments in finalizing Rule 9j-1. As discussed above and in the 2021 Proposing Release, some security-based swap market participants may incur costs associated with taking actions to update existing compliance systems for compliance with Rule 9j-1. These additional costs could be limited to the extent that many of these practices and systems are already in place to ensure compliance with section 9(j) and the other general antifraud and anti-manipulation statutory and regulatory provisions. To the extent that market participants incur compliance costs as a result of Rule 9j-1, these costs represent a reasonable trade-off in light of the benefits discussed in section V.D.1. With respect to the identification, tracking, and coordination activities that might be necessary absent an information barrier safe harbor, final Rule 9j-1(e)(2) provides an affirmative defense modeled on the affirmative defense in Rule 10b5-1(c)(2). Final Rule 9j-1(e)(2) will help mitigate the cost and effort that market participants may incur to identify, track, and coordinate activities involving security-based swaps and related reference underlying entities held by the organization.

Several commenters were concerned that re-proposed Rule 9j-1's liability standards are vague and that such vagueness would foster significant uncertainty among security-based swap market participants, resulting in reduced market participation, liquidity, capital formation, and investor choice.[327] In response to these concerns, the Commission clarifies the liability standards of Rule 9j-1 in section II of this release. Specifically, the liability standards in the rule follow the well-settled standards in section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, section 17(a) of the Securities Act, and applicable case law. The Commission also explains why a non-scienter-based standard is appropriate for paragraphs (a)(3) and (a)(4) of final Rule 9j-1 and is consistent with sections 17(a)(2) and (3) of the Securities Act, on which they are based.

Where commenters noted a discrepancy in the Commission's proposed rule and the legal standard for certain attempted offenses, the Commission revised the rule to conform to the legal

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327 *See* IACPM Letter at 4-5; IIB-ISDA-SIFMA Letter at 1-3, 5, 13-14; LSTA Letter at 3, 5, 7; Milbank Letter at 1-5, 7, 9-10; July 2022 MFA Letter at 1, 6, 7.

standard in new Rule 9j-1(a)(5). These revisions should address any uncertainty that security-based swap market participants may have regarding the rule's liability standards. In addition, the Commission is adopting Rule 9j-1(e), which includes two affirmative defenses for violations of the provisions in paragraphs (a)(1) through (a)(5) of Rule 9j-1.[328] The final rule conforms the affirmative defenses in Rule 9j-1(e) to those in existing Rule 10b5-1(c). The revisions regarding the liability standards of Rule 9j-1 coupled with the affirmative defenses of Rule 9j-1(e) should mitigate any potential adverse effects on market participation, liquidity, capital formation, and investor choice. Moreover, by reducing the risk of fraudulent and manipulative activity in the security-based swap market, Rule 9j-1 would increase market participation, liquidity, capital formation, and investor choice thereby further mitigating the potential adverse effects that commenters identified.[329]

One commenter was concerned that the inclusion of interim actions in the performance of contractual obligations within the scope of re-proposed Rule 9j-1 will discourage market participants from transacting in security-based swaps, reduce liquidity in the security-based swap markets, increase the cost of capital, and reduce the availability of capital.[330] The Commission does not believe the final rule will adversely affect market participation, liquidity, cost of capital, and availability of capital in the manner described by the commenter. Final Rule 9j-1 applies to fraudulent, deceptive, or manipulative misconduct related to the exercise of any right or performance of any obligation under a security-based swap if such misconduct occurs in connection with effecting or attempting to effect a transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, a security-based swap. Moreover, the rule addresses actions taken outside the ordinary course of a typical lender-borrower relationship (or a prospective lender-borrower relationship). Accordingly, by reducing the risk of fraudulent

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328 *See* final Rule 9j-1(e).

329 *See supra* section V.D.1.

330 MFA Letter at 2, 8-9.

and manipulative activity in the security-based swap market, Rule 9j-1 will increase liquidity in the markets for security-based swaps and underlying cash instruments, and lower capital costs and increase capital formation for reference underlying entities.[331]

Some commenters were concerned that the Commission's choice of a negligence standard for re-proposed Rules 9j-1(a)(3) and (4), coupled with the omission of Rule 10b5-1(c)(2) affirmative defenses, would discourage market participants from entering into security-based swaps and would, as a result, reduce liquidity in security-based swap markets, exacerbate risks for market participants, and increase issuers' cost of capital. These commenters were concerned that lenders may also reduce their lending activities, which would reduce financing to private companies.[332] In response to comments received on the 2021 Proposing Release, paragraphs (a)(3) and (a)(4) of new Rule 9j-1 describe conduct for which a non-scienter based standard would apply, while paragraph (a)(5) of new Rule 9j-1 describes attempts of that conduct for which scienter is the proper standard. In addition, Rule 9j-1(e)(2) provides for an affirmative defense that is modeled on the affirmative defense in Rule 10b5-1(c)(2). These changes from re-proposed Rule 9j-1 should address the commenters' concerns and mitigate any potential adverse effects on liquidity, risks, cost of capital, and financing to private companies.

Some commenters stated that proposed Rule 9j-1(b) would create uncertainty and implicate a wide range of innocuous and ordinary course activities that are essential to markets in both security-based swaps and underlying cash instruments. The commenters stated that this would materially increase compliance costs for security-based swap market participants, reduce participation in security-based swap and securities markets, reduce lending activity and capital formation, and raise issuers' cost of capital.[333] As discussed above, final Rule 9j-1(a)(6), as revised from proposed Rule 9j-1(b), will apply to conduct undertaken in connection with

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331 *See supra* section V.D.1.

332 *See* ACLI Letter at 5-6; MFA Letter at 2, 13-16.

333 *See* MFA Letter at 16-19; Milbank Letter at 9-10.

effecting or attempting to effect a transaction in any security-based swap, and to purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap (including but not limited to, in whole or in part, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security based-swap). Rule 9j-1(a)(6) also prohibits the manipulation (or attempted manipulation) of the valuation of any security-based swap, or any payment or delivery related thereto, to the extent such misconduct is in connection with effecting or attempting to effect a transaction in, or purchasing or selling, or inducing or attempting to induce the purchase or sale of, any security-based swap. The final rule strikes an appropriate balance between preventing manipulation and attempted manipulation in the security-based swap market and addressing commenters' concern. A narrowing in the scope of final Rule 9j-1(a)(6) would create a gap in the prohibition against manipulation and attempted manipulation in the security-based swap market and reduce the benefits of the rule.

A determination as to whether a person has violated final Rule 9j-1(a)(6) will depend on the facts and circumstances of each particular situation. Further, a scienter standard will be used to determine whether conduct is in violation of the rule. With respect to the loan market, final Rule 9j-1(a)(6) applies to actions taken outside the ordinary course of a typical lender-borrower relationship, such as an action taken for the purposes of avoiding or causing, or increasing or decreasing, a payment under a security-based swap in a manner that would not have occurred but for such actions, or when an action appears to be designed almost exclusively to harm counterparties, and is not intended to discourage lenders from discussing or providing financing or relief to avoid default. To be clear, Rule 9j-1(a)(6) will require that security-based swap market participants take care that their legitimate market activities remain within the scope of the typical lender-borrower relationship and do not cross the line into prohibited manipulation. The foregoing discussion should help address concerns related to uncertainty that the rule may create and the proposed rule's scope.

However, to the extent that market participants continue to have such concerns, final Rule 9j-1(a)(6) could increase compliance costs, reduce market participation, reduce lending activity and capital formation, and raise issuers' cost of capital. That said, by reducing the risk of fraudulent and manipulative activity in the security-based swap market, Rule 9j-1 would increase market participation, increase lending activity and capital formation, and lower issuers' cost of capital thereby mitigating the potential adverse effects that commenters identified. Further, to the degree that Rule 9j-1 provides additional precision and specificity regarding the application of existing antifraud and anti-manipulation laws to misconduct in the security-based swap market, some market participants may need to spend fewer resources determining appropriate compliance under section 9(j) of the Exchange Act and reduce their compliance costs.[334]

E. Benefits and Costs of Rule 15fh-4(c)

1. Benefits

Rule 15fh-4(c) makes it unlawful for any officer, director, supervised person, or employee of an SBS Entity, or any person acting under such person's direction, to take, directly or indirectly, any action to coerce, mislead, or otherwise interfere with the SBS Entity's CCO. This prohibition would support the ability of the CCO to meet the CCO's important obligations to foster compliance in its role of overseeing compliance within the SBS Entity. Rule 15fh-4(c) will make it more likely that a CCO is able to more efficiently and effectively execute the CCO's responsibilities to foster compliance, including for example, by ensuring that the SBS Entity maintains and reviews written policies and procedures reasonably designed to achieve compliance with the rules and regulations relating to the business of the SBS Entity. Ultimately, these effects will likely also reduce the risk of fraud, market manipulation, or other fraudulent activities in the security-based swap market, providing additional protection for both counterparties in the security-based swap transaction and the underlying entity.

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334 *See supra* section V.D.1.

Rule 15fh-4(c) will encourage officers, directors, supervised persons, and employees of SBS Entities to exercise reasonable attention and care in their dealings with CCOs, as discussed in section III.B. To the extent that such exercise of reasonable attention and care increases the quantity and quality of information exchanged between CCOs, officers, directors, supervised persons, and employees of SBS Entities, CCOs may more efficiently and effectively foster compliance in SBS Entities. Any resulting improvement in compliance in turn could reduce the risk of fraud, market manipulation, or other fraudulent activities in the security-based swap market. More broadly, improved communication between CCOs, officers, directors, supervised persons, and employees of SBS Entities also could facilitate decision making within the SBS Entities.

Rule 15fh-4(c) would likely have minor indirect positive impacts on competition, price efficiency, and capital formation, as discussed in section V.F.

Comments received

Two commenters believed that proposed Rule 15Fh-4(c) would deter the types of actions that prevent CCOs from performing their duties and that deterring such actions would in turn help protect the CCOs' independence and objectivity in the fulfillment of their duties.[335] The Commission agrees with the commenters that Rule 15fh-4(c)'s benefit could derive in part from deterring actions that are prohibited by the rule.

2. Costs

Rule 15fh-4(c)'s prohibition on taking actions to coerce, mislead, or otherwise interfere with the SBS Entity's CCO, may create additional costs for SBS Entities. For example, to the extent that any current practices of an SBS Entity include activities that are explicitly prohibited under Rule 15fh-4(c), applicable policies and procedures will need to be updated. In addition, it is possible that the rule could cause officers, directors, supervised persons, or employees of an SBS Entity to be overly cautious when consulting with a CCO. The Commission does not,

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335 *See* Better Markets Letter at 14; NYC Bar Letter at 4-5.

however, believe that any such effects will be significant, given the specificity of the rule's prohibition on certain interferences with the SBS Entity's CCO.

Comments received

One commenter was concerned that the scope of the proposed rule is unclear and could lead to confusion and uncertainty as to what communications between the CCO and the officers, directors, supervised persons, and employees of the SBS Entity might violate the rule. The commenter states that such confusion and uncertainty could have a chilling effect on dialog about compliance, budget, and resource matters, which, by implication, could impede decision making within the SBS Entity.[336] In response to this comment, the Commission has clarified the scope of final Rule 15fh-4(c) in section III.B. Further, the Commission clarified that the acts to "coerce, manipulate, mislead or fraudulently influence" that would be prohibited by Rule 15fh-4(c) imply compelling the CCO to act in a certain way through pressure, threats, trickery, intimidation, misrepresentation, or some other form of purposeful action not limited to untrue statements or omissions of material facts. As discussed in section V.E.1, to the extent that the rule encourages officers, directors, supervised persons, and employees of SBS Entities to exercise reasonable attention and care in their dealings with CCOs, communication and decision making could improve within the SBS Entities and mitigate any potential adverse impact on decision making suggested by the commenter.

F. Effects on Efficiency, Competition, and Capital Formation

The final rules would likely affect capital formation, competition, and efficiency in various ways, as discussed below.

1. Competition

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336 IIB-ISDA-SIFMA CCO Letter at 1-2.

As discussed earlier, by reducing the risk of fraud, Rule 9j-1 could encourage participation in the market, which may result in increased competition in the security-based swap market.[337]

Rule 15fh-4(c) would likely have a minor indirect positive impact on competition in the security-based swap market. Because Rule 15fh-4(c) would support the ability of the CCO to oversee compliance with the Federal securities laws within the SBS Entity and likely reduce the risk of fraud, security-based swaps would more likely reflect the fundamental credit risk of the underlying entity. This in turn could encourage greater participation in the security-based swap market and therefore, increase competition among the market participants.

2. Efficiency

By decreasing the risk of fraud and preventing price manipulation in the security-based swap market, Rule 9j-1 may increase price efficiency. This would consequently lead to greater security-based swap market efficiency, as security-based swap prices would provide greater confidence that their prices more likely reflect fundamental values and risk in more liquid markets.[338]

Rule 15fh-4(c) would likely have a minor indirect positive impact on price efficiency. To the extent that the rule increases participation in the security-based swap market as discussed in section V.F.1, price efficiency may increase because increased trading by market participants could incorporate more information into security-based swap prices.

3. Capital formation

Final Rule 9j-1 likely would have a positive impact on capital formation. As discussed earlier, greater activity in the underlying security market due to increased price efficiency and greater availability to hedge these securities in the security-based swap market could lead to lower capital costs and increase capital formation for the underlying entities. Increased

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337 *See supra* section V.D.1.

338 *Id*.

participation and price efficiency in the security-based swap market as a result of Rule 9j-1 could encourage lenders to make greater use of security-based swaps for hedging their loans, which in turn could increase lending activity and capital formation.[339] To the extent that the rule lowers litigation costs and compliance costs for market participants and underlying entities, these market participants and entities could in turn use the resources that are freed up to invest in projects.

As discussed in section V.D.2, a number of commenters were concerned that re-proposed Rule 9j-1's compliance costs, scope, and liability standards would reduce capital formation (including financing to private companies) and increase the cost of capital, among other potential effects. As discussed in that section, compliance costs could be limited by existing practices and systems that are in place to comply with section 9(j) and the other antifraud and anti-manipulation provisions; that the rule's use of clear, consistent, and familiar liability standards reduces uncertainty; and that the rule's beneficial effects on capital formation and the cost of capital would mitigate any potential adverse effects that commenters identified.

Rule 15fh-4(c) would likely have a minor indirect positive impact on capital formation. To the extent that the rule increases price efficiency and competition in the security-based swap market, as discussed in sections V.F.1 and V.F.2, capital formation could, as a result, further indirectly increase, as greater price efficiency and competition among market participants could lead to a decrease in security-based swaps prices, and in turn, lower costs of borrowing (as a result of lowering the cost of CDS).

G. Reasonable Alternatives

The Commission considered a number of alternatives when finalizing Rules 9j-1 and 15fh-4(c).

1. Narrow the Scope of Rule 9j-1

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339 *Id.*

Commenters recommended narrowing the scope of re-proposed Rule 9j-1 in various ways: (1) exclude valuation, payment, and delivery from the scope of proposed Rule 9j-1(b);[340] (2) exclude certain credit market conduct from the scope of proposed Rule 9j-1(b);[341] and (3) exclude security-based swaps referencing sovereign debt from the scope of re-proposed Rule 9j-1.[342]

The Commission has considered these alternatives but determined that the adopted approach is preferable to them. With respect to the exclusion of valuation, payment, and delivery from the scope of proposed Rule 9j-1(b), the Commission declines to adopt this alternative. The Commission is concerned that the alternative would create a gap in the prohibition against the manipulation and attempted manipulation of prices in the security-based swap market and reduce the benefits of final Rule 9j-1(a)(6), as revised from proposed Rule 9j-1(b). The exclusion of valuation, payment, and delivery from the scope of final Rule 9j-1(a)(6) could increase the occurrence of manipulation and attempted manipulation of security-based swap prices in connection with such activities.

With respect to the exclusion of certain credit market conduct, the Commission believes it cannot specify all possible types of misconduct that may prevail in the future. Hence, provisions designed to exclude certain legitimate credit market conduct could unintentionally apply to activities that final Rule 9j-1(a)(6), as revised from proposed Rule 9j-1(b), is designed to prohibit, reducing the benefits of the rule. Further, an exclusion of certain credit market conduct would need to be balanced against the risk that market participants undertake transactions for which their counterparties should have the protections of final Rule 9j-1(a)(6). In addition, as discussed in section II.C.2, the fact that the Commission intends to apply a scienter standard in connection with final Rule 9j-1(a)(6), and that the rule does not impose liability for actions taken

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340 Milbank Letter at 5.

341 *See* IACPM Letter at 4; IIB-ISDA-SIFMA Letter at 18-19; Milbank Letter at 4-5.

342 ACLI Letter at 3, 13-14.

in the ordinary course of a typical lender-borrower relationship (or a prospective lender-borrower relationship), should help mitigate concerns regarding any "chilling effects" of the rule.

With respect to the exclusion of sovereign debt security-based swaps, as a general matter, the Commission does not see a compelling reason to treat security-based swaps referencing sovereign underliers differently than security-based swaps referencing other underliers. As discussed in section II.E.2.d, while security-based swaps related to sovereign debt may have lesser opportunity for manufactured credit events or opportunistic strategies by regulated and non-regulated market participants alike, such instruments are not without risk of fraudulent and manipulative conduct and should remain within the scope of Rule 9j-1.[343] Further, the Commission is concerned that the alternative would create a gap in the prohibition against fraudulent and manipulative activity in the security-based swap market. Even if, as the commenter asserted, manufactured credit events related to a country's sovereign debt are unlikely, other types of fraudulent and manipulative activities could be perpetrated in connection with sovereign debt security-based swaps.[344] The alternative would not prohibit these activities and could increase their occurrence. In light of the above, the adopted approach is preferable to this alternative.

2. Safe Harbors

Commenters suggested that the Commission add various safe harbors to Rule 9j-1. The Commission discusses these alternatives below.

a. Safe Harbor for Hedging Exposure Arising Out of Lending Activities

One commenter urged the Commission to consider creating a safe harbor to re-proposed Rule 9j-1 for entering into security-based swap transactions for purposes of hedging some or all

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343 *See supra* note 244 and related discussion.

344 *See* ACLI Letter at 13 (stating that it seems unlikely that any holders of security-based swaps on sovereign debt would possess the leverage necessary to manufacture credit events related to a country's sovereign debt).

exposure arising out of lending activities with a reference entity or the syndication of such lending activities.[345] Such a safe harbor could minimize the effects of the rule on risk-reducing hedging activity, which is one of the central purposes of CDS contracts and which provides important benefits to the lending market. Identifying legitimate, risk-reducing hedging activity – undertaken with the intent of covering potential losses in a position – and distinguishing such activity from other types of speculative transactions would likely be difficult. Hence, even a safe harbor designed to apply solely to legitimate hedging transactions could unintentionally apply to activities that Rule 9j-1 is designed to prohibit, reducing the benefits of the rule. Further, such a safe harbor would need to be balanced against the risk that market participants undertake transactions for which their counterparties should have the protections of Rule 9j-1, including in circumstances involving potentially opportunistic trading strategies. In light of the above, the adopted approach is preferable to this alternative.

b. Safe Harbors for Lender Disclosure, Centralized Market Activities, and Legitimate Restructurings

One commenter urged the Commission to consider allowing the lender to avoid liability under re-proposed Rule 9j-1 by disclosing to the counterparty that it is a lender to the borrower and may have material nonpublic information from the borrower.[346] Another commenter urged the Commission to provide safe harbors for certain centralized market activities: (1) multilateral amendment exercises (including ISDA protocols) or bilateral equivalents; and (2) participation in determination committees in accordance with the determination committees' rules and any applicable codes of conduct.[347] A third commenter suggested that the Commission provide a safe harbor or exception for legitimate restructurings to avoid limiting the supply of funds to issuers during a restructuring.[348] The affirmative defenses in Rule 9j-1(e) will serve the same purpose as

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345 LSTA Letter at 8.

346 *Id.* at 9.

347 IIB-ISDA-SIFMA Letter at 11-12.

348 Fletcher Letter at 4.

these alternatives by permitting persons to enter into certain types of activity, pursuant to the requirements of the affirmative defenses, while also addressing concerns about fraud and manipulation for the entire security-based swap market. With respect to the suggested safe harbor for legitimate restructurings, identifying legitimate restructurings and distinguishing such activities from other types of speculative transactions would likely be difficult. Hence, even a safe harbor designed to apply solely to legitimate restructurings could unintentionally apply to activities that Rule 9j-1 is designed to prohibit, reducing the benefits of the rule. Further, such a safe harbor would need to be balanced against the risk that market participants undertake transactions for which their counterparties should have the protections of Rule 9j-1, including in circumstances involving potentially opportunistic trading strategies. Accordingly, the adopted approach is preferable to these alternatives.

c. Safe Harbor for Publicly Executed Strategies

One commenter requested a safe harbor from liability under proposed Rule 9j-1(b) for publicly executed strategies, where multiple parties or an independent body (such as a court or regulator) are involved. The commenter distinguished publicly executed strategies from privately executed strategies, such as a single market participant entering into an agreement with a reference entity. The commenter argued that publicly executed strategies are more difficult for a single participant to manipulate than privately executed strategies because publicly executed strategies are driven by the incentives of a broader group of participants than privately executed strategies.[349] The Commission declines to adopt this alternative. While publicly executed strategies may be difficult for a single participant to manipulate as the commenter argued, it is not clear that such strategies would remain difficult to manipulate when a group of market participants are acting in concert to manipulate such strategies. The Commission is concerned that providing a safe harbor for publicly executed strategies would encourage manipulative

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[349] IIB-ISDA-SIFMA Letter at 17.

activity involving a coalition of market participants. That said, the Commission appreciates that there are legitimate publicly executed strategies that are not involved in manipulative activity. In section II.C.2, the Commission discusses at length the application of final Rule 9j-1(a)(6) and believes the discussion should alleviate concerns that legitimate publicly executed strategies may violate the rule.

d. Elimination of All Safe Harbors and Affirmative Defenses

Four commenters urged for the elimination of all safe harbors and affirmative defenses from proposed Rule 9j-1(a) liability.[350] The adopted approach, which among other things, provides two affirmative defenses in final Rule 9j-1(e), is preferable to the alternative. As discussed in section V.D.2, the two affirmative defenses will help mitigate various adverse effects (*e.g.,* reduced market participation) that certain commenters believed may arise as a result of Rule 9j-1. Final Rule 9j-1(e)(2) will help mitigate the cost and effort that market participants may incur to identify, track, and coordinate activities involving security-based swaps and related reference underlying entities held by the organization. At the same time, the costs that market participants may incur in connection with these affirmative defenses likely would be very limited.[351]

3. Implementing a More Prescriptive Approach in Rule 9j-1

One commenter urged the Commission to consider the alternative approach of identifying and prohibiting within Rule 9j-1 specific types of events (for example, market behavior around certain events and fact patterns) and opportunistic trading behavior that have been observed. According to the commenter, this alternative approach could provide even more certainty and precision with respect to the particular types of activities that are prohibited in the security-based swap market. The commenter believed that the greater certainty of outcome with respect to Rule

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350 Better Markets Letter at 2, 9-12; Anonymous Penguin Comments at 1; J.T. Comments at 1; Michael Comments at 1.

351 *See supra* section V.D.2.

9j-1 would benefit lenders when they need to exercise rights or remedies under a loan or credit agreement.[352] However, this approach could lead to greater uncertainty with respect to circumstances not explicitly contemplated in the rule, which could increase litigation costs for market participants involved in such transactions. This approach may also decrease the integrity of the market for security-based swaps, and in addition, could cause market participants to bear greater compliance costs in connection with the evaluation of circumstances not explicitly contemplated in the rule. As a result, the more prescriptive alternative approach would have limited benefits and greater costs as compared to the adopted approach in the market for security-based swaps, as well as the market for the reference underlying of such security-based swaps.

The Commission acknowledges the commenter's concern that not adopting the more prescriptive alternative approach could prevent lenders or security-based swap participants from exercising legitimate rights and remedies and impose costs that would be greater than those discussed in the 2021 Proposing Release in connection with re-proposed Rule 9j-1.[353] Final Rule 9j-1 would enable lenders or security-based swap participants to exercise legitimate rights and remedies, thereby addressing the commenter's concern. In particular, paragraphs (a)(3) and (a)(4) of final Rule 9j-1 describe conduct for which a non-scienter based standard would apply, while paragraph (a)(5) of final Rule 9j-1 describes attempted aspects of that conduct for which scienter is the proper standard. In addition, final Rule 9j-1(e) provides for affirmative defenses similar to the affirmative defenses in Rule 10b5-1(c). The clarification regarding the liability standards of Rule 9j-1 coupled with the affirmative defenses of Rule 9j-1(e) should mitigate any potential adverse effects on market participation, liquidity, capital formation, and investor choice. Moreover, by reducing the risk of fraudulent and manipulative activity in the security-based swap market, Rule 9j-1 would increase market participation, liquidity, capital formation,

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352 LSTA Letter at 7.

353 *Id.*

and investor choice thereby further mitigating the potential adverse effects that commenters identified.

4. Separate Rules for CDS and Equity Security-Based Swaps

One commenter asserted that opportunistic strategies work best with CDS and that equity SBS are less susceptible to such strategies. The commenter suggested that the Commission propose separate rules for each type of instrument.[354] The Commission has considered the commenter's suggested alternative, but believes that the adopted approach is preferable to the alternative. The aim of Rule 9j-1 is to address fraud and manipulation in the security-based swap market and is not limited to addressing fraud and manipulation in connection with certain opportunistic strategies that historically have been implemented with CDS. As discussed in section II, fraudulent and manipulative conduct has the potential to harm counterparties to all forms of security-based swaps, including CDS, equity security-based swaps, and non-CDS debt security-based swaps. Rule 9j-1 is appropriately tailored to address fraud and manipulation for the entire security-based swap market. As such the Commission does not see the need to adopt separate rules for CDS and equity security-based swaps.

5. Exclude Underlying Securities

One commenter urged the Commission to modify re-proposed Rule 9j-1 by providing that its prohibitions do not extend to the purchase or sale of underlying securities.[355] The Commission declines to adopt this alternative. Because security-based swaps by their nature are tied intrinsically to activity in other securities markets, persons that intend to perpetrate fraudulent or manipulative activity with respect to a security-based swap may choose to do so by purchasing or selling the underlying security. The alternative would create a gap in the prohibition against fraudulent and manipulative activity in connection with security-based swaps and increase the risk of such activity to the detriment of investors. In contrast, final Rule 9j-1(c)

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354 Fletcher Letter at 4.

355 MFA Letter at 2, 8-9.

is designed so that a person cannot escape liability under section 9(j) of the Exchange Act or Rule 9j-1(a) with respect to a security-based swap by limiting all of its actions to purchases or sales of the security or narrow-based security index underlying that security-based swap.

6. Limit Activities Prohibited Under Rule 15fh-4(c)

One commenter suggested that final Rule 15fh-4(c) should limit the prohibited interference to knowingly making untrue statements or omitting material facts.[356] As discussed in section III.B, Rule 15fh-4(c) protects the independence and objectivity of an SBS Entity's CCO by prohibiting undue influence by other personnel. Such influence could take many forms and is not limited to material misstatements or omissions. The Commission is concerned that limiting prohibited activities to material misstatements and omissions, as suggested by the commenter, would fail to adequately protect the CCO from undue influence and consequently reduce the rule's benefit. As discussed in section V.E.1, by encouraging officers, directors, supervised persons, and employees of SBS Entities to exercise reasonable attention and care in their dealings with CCOs, final Rule 15fh-4(c) would foster compliance in SBS Entities, reduce the risk of fraudulent and manipulative conduct, and facilitate decision making in SBS Entities. The suggested alternative, by its limited nature, may be less likely to encourage such exercise of reasonable attention and care in dealings with CCOs. Accordingly, the adopted approach is preferable to the alternative.

VI. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act ("RFA")[357] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a) of the Administrative Procedure Act,[358] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine

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356 ISDA-IIB-SIFMA CCO Letter at 2.

357 5 U.S.C. 601 *et seq.*

358 5 U.S.C. 603(a).

the impact of such rulemaking on "small entities."[359] Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule or proposed rule amendment which, if adopted, would not have a significant economic impact on a substantial number of small entities.[360] The Commission certified in the 2021 Proposing Release that new Rules 9j-1 and 15fh-4(c) would not have a significant economic impact on any "small entity" for purposes of the RFA.[361] The Commission received no comments on its certification.

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (1) when used with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of $5 million or less;[362] or (2) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17a-5(d) under the Exchange Act,[363] or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[364]

Based on available information about the security-based swap market, the market, while broad in scope, is largely dominated by entities such as those that will be covered by the SBSD and MSBSP definitions. Based on feedback from industry participants about the security-based

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359 Although section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this rulemaking, are set forth in 17 CFR 240.0-10 ("Rule 0-10") under the Exchange Act. *See* Final Definitions of "Small Business" and "Small Organization" for Purposes of the Regulatory Flexibility Act, Exchange Act Release No. 18452 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982) (File No. S7-879).

360 *See* 5 U.S.C. 605(b).

361 *See* 2021 Proposing Release, 87 FR at 6702-03.

362 *See* 17 CFR 240.0-10(a).

363 17 CFR 240.17a-5(d).

364 *See* 17 CFR 240.0-10(c).

swap market, the Commission continues to believe that: (1) the types of entities that are and will continue to register with the Commission as SBSDs (*i.e.*, because they engage in more than a de minimis amount of dealing activity involving security-based swaps) – which generally would be large financial institutions – would not be "small entities" for purposes of the RFA; and (2) the types of entities that may have security-based swap positions above the level required to register as MSBSPs would not be "small entities" for purposes of the RFA.

Although Rule 15fh-4(c) applies only to SBS Entities, Rule 9j-1 is not on its face limited to SBS Entities. However, while it is possible that other parties may engage in security-based swap transactions, the Commission does not believe that any such entities would be "small entities" as defined in Exchange Act Rule 0-10.[365] Feedback from industry participants about the security-based swap market indicates that only persons or entities with assets significantly in excess of $5 million (or with annual receipts significantly in excess of $7 million) participate in the security-based swap market. With respect to Rule 9j-1, even to the extent that a small number of transactions did have a counterparty that was defined as a "small entity" under Rule 0-10, the Commission believes it unlikely that the rule would have a significant economic impact on such entities, as the rule prohibits fraudulent and manipulative acts, activities which are in most cases already prohibited.

For the foregoing reasons, the Commission certifies that Rules 9j-1and 15fh-4(c) will not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

VII. Other Matters

Pursuant to the Congressional Review Act,[366] the Office of Information and Regulatory Affairs has designated these rules as not a "major rule," as defined by 5 U.S.C. 804(2).

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365 *See* 17 CFR 240.0-10(a).

366 5 U.S.C. 801 *et seq*.

If any of the provisions of these final rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Statutory Authority

The Commission is adopting the new rules and rule amendment contained in this release under the authority set forth in the Exchange Act, 15 U.S.C. 78a *et seq*., as amended, and, particularly sections 2, 3(b), 9(i), 9(j), 10, 15, 15F, and 23(a) thereof (15 U.S.C. 78b, 78c(b), 78i(i), 78i(j), 78j, 78*o*, 78*o*-10, and 78w(a)).

List of Subjects in 17 CFR Part 240

Administrative practice and procedure, Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities, Swaps.

Text of the Final Rule

For the reasons set forth in the preamble, title 17, chapter II of the Code of Federal Regulations is amended as follows:

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

1. The general authority citation for part 240 continues to read, and the sectional authority for §240.15fh-1 is revised to read, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78j-4, 78k, 78k-1, 78*l*, 78m, 78n, 78n-1, 78*o*, 78*o*-4, 78*o*-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78dd, 78*ll*, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et seq*., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111-203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112-106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

Sections 240.15fh-1 through 240.15Fh-6 and 240.15Fk-1 are also issued under sec. 943, Pub. L. 111–203, 124 Stat. 1376.

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§§ 240.10a-1 and 240.10a-2 [Amended]

2. Move reserved §§ 240.10a-1 and 240.10a-2 from undesignated center heading "Hypothecation of Customers' Securities" to undesignated center heading "Manipulative and Deceptive Devices and Contrivances" in numerical order.

3. Add § 240.9j-1 under the undesignated center heading "Manipulative and Deceptive Devices and Contrivances" to read as follows:

§ 240.9j-1 Prohibition against fraud, manipulation, or deception in connection with security-based swaps.

(a) It shall be unlawful for any person, directly or indirectly, to effect any transaction in, or attempt to effect any transaction in, any security-based swap, or to purchase or sell, or induce or attempt to induce the purchase or sale of, any security-based swap (including but not limited to, in whole or in part, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security based-swap, as the context may require), in connection with which such person:

(1) Employs or attempts to employ any device, scheme, or artifice to defraud or manipulate;

(2) Makes or attempts to make any untrue statement of a material fact, or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading;

(3) Obtains 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;

(4) Engages in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person;

(5) Attempts 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, or attempts to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person; or

(6) Manipulates or attempts to manipulate the price or valuation of any security-based swap, or any payment or delivery related thereto.

(b) Wherever communicating, or purchasing or selling a security (other than a security-based swap) while in possession of material nonpublic information would violate, or result in liability to any purchaser or seller of the security under, either the Act or the Securities Act of 1933, or any rule or regulation thereunder, such conduct in connection with a purchase or sale of a security-based swap with respect to such security or with respect to a group or index of securities including such security shall also violate, and result in comparable liability to any purchaser or seller of that security under, such provision, rule, or regulation.

(c) Wherever taking any of the actions set forth in paragraph (a) of this section involving a security-based swap would violate, or result in liability under, Section 9(j) of the Act or this section, such conduct, when taken by a counterparty to such security-based swap (or any affiliate of, or a person acting in concert with, such security-based swap counterparty in furtherance of such prohibited activity), in connection with a purchase or sale of a security, loan, or group or index of securities on which such security-based swap is based, shall also violate, and shall be deemed a violation of, section 9(j) of the Act or paragraph (a) of this section.

(d) For purposes of this section, the terms “purchase” and “sale” shall have the same meanings as set forth in Sections 3(a)(13) (15 U.S.C. 78c(a)(13)) and 3(a)(14) (15 U.S.C. 78c(a)(14)) of the Act.

(e) A person shall not be liable under paragraphs (a)(1) through (a)(5) of this section solely for being aware of material nonpublic information while taking the following actions:

(1) Actions taken by a person in accordance with binding contractual rights and obligations under a security-based swap (as reflected in the written documentation governing such security-based swap or any amendment thereto) so long as the person demonstrates that:

(i) The security-based swap was entered into, or the amendment was made, before the person became aware of such material nonpublic information, and

(ii) The security-based swap was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of this section.

(2) Actions taken by a person other than a natural person if the person demonstrates that:

(i) The individual making the investment decision on behalf of the person taking the action was not aware of the material nonpublic information, and

(ii) The person had implemented reasonable policies and procedures, taking into consideration the nature of the person's business, to ensure that individuals making investment decisions would not be in violation of paragraphs (a)(1) through (a)(5) of this section. These policies and procedures may include those that restrict effecting a transaction in, or purchasing or selling, any security, including any security-based swap, as to which the person has material nonpublic information, or those that prevent such individuals from becoming aware of such information.

4. Redesignate § 240.15Fh-4 as § 240.15fh-4 and amend newly redesignated § 240.15fh-4 by:

a. Revising the section heading; and

b. Adding paragraph (c).

The revisions read as follows:

§ 240.15fh-4 (Rule 15fh-4) Antifraud provisions for security-based swap dealers and major security-based swap participants; special requirements for security-based swap dealers acting as advisors to special entities.

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(c) *No undue influence over chief compliance officer*. It shall be unlawful for any officer, director, supervised person, or employee of a security-based swap dealer or major security-based swap participant, or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the security-based swap dealer's or major security-based swap participant's chief compliance officer in the performance of their duties under the Federal securities laws or the rules and regulations thereunder.

By the Commission.

Dated: June 7, 2023.

Vanessa A. Countryman,

Secretary.

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