SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–93784; File No. S7–32–10]

RIN 3235–AK77

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

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: The Securities and Exchange Commission (''SEC'' or ''Commission'') is re-proposing for comment a rule under the Securities Exchange Act of 1934 (''Exchange Act''), which would be a new rule designed to prevent fraud, manipulation, and deception in connection with effecting transactions in, or inducing or attempting to induce the purchase or sale of, any security-based swap. The rule is designed specifically to take into account the unique features of a security-based swap and would explicitly reach misconduct in connection with the ongoing payments and deliveries that typically occur throughout the life of a security-based swap. The Commission also is proposing a new rule, which would make it 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 (''CCO'') in the performance of their duties under the federal securities laws or the rules and regulations thereunder. Finally, the Commission is using its authority under the Exchange Act to propose for comment a new rule, 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 position.

DATES: Comments should be received on or before March 21, 2022.

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

Electronic Comments

- Use the Commission's internet comment form (*https://www.sec.gov/rules/regulatory-actions/how-to-submit-comments*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number S7–32–10 on the subject line; or

Paper Comments

- Send paper comments to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7–32–10. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (*http://www.sec.gov/rules/proposed.shtml*). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Room 1580, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Operating conditions may limit access to the Commission's public reference room. All comments received will be posted without change. Persons submitting comments are cautioned that the Commission does not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make publicly available.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the SEC's website. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Carol M. McGee, Assistant Director, at (202) 551–5870, Office of Derivatives Policy, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–8010.

SUPPLEMENTARY INFORMATION: The Commission is re-proposing for comment 17 CFR 240.9j–1 (''Rule 9j–1'') under the Exchange Act, which would be a new rule designed to prevent fraud, manipulation, and deception in connection with effecting transactions in, or inducing or attempting to induce the purchase or sale of, any security-based swap. The Commission also is proposing new 17 CFR 240.15Fh–4(c) (''Rule 15Fh–4(c)'') under the Exchange Act, which would make it 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 CCO in the performance of their duties under the Federal securities laws or the rules and regulations thereunder. Finally, the Commission is using its authority under Section 10B(d) of the Exchange Act to propose for comment new 17 CFR 240.10B–1 (''Rule 10B–1''), 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 among other things: (1) The applicable security-based swap position; (2) positions in any security or loan underlying the security-based swap position; and (3) any other instrument relating to the underlying security or loan, or group or index of securities or loans. Proposed Rule 10B–1 includes different reporting thresholds for security-based swaps tied to debt securities and security-based swaps tied to equity securities. The Commission would make all filings received pursuant to proposed Rule 10B–1 available to the public, with the goal of increasing transparency and oversight in the security-based swap market.

I. Introduction

A. Background

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act''),[1] which established a regulatory framework for the over-the-counter (''OTC'') derivatives market, provides that the Commission is primarily responsible for regulating security-based swaps, while the Commodity Futures Trading Commission (''CFTC'') is primarily responsible for regulating swaps. The Commission has now finalized a majority of its Title VII rules related to security-based swaps.[2] In accordance with those rules, a person who satisfies the definitions of ''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'') is now required to register with the Commission in such capacity and is therefore subject to the Commission's regime regarding margin, capital, segregation, recordkeeping and reporting, trade acknowledgment and verification requirements, risk mitigation techniques for uncleared security-based swaps, business conduct standards for security-based swap activity, including internal supervision requirements and the requirement to designate an individual to serve as the CCO who must take 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.[3] Transaction reporting for security-based swaps has been required since November 8, 2021, with public dissemination to begin on February 14, 2022.[4]

In addition to the operational rules for SBS Entities and security-based swap data reporting and public dissemination, 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. 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

[1] Wall Street Transparency and Accountability Act of 2010, Public Law. 111–203, § 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.,* Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 74244 (Feb. 11, 2015), 80 FR 14563 (Mar. 19, 2015) (''2015 Regulation SBSR Adopting Release''); Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 74246 (Feb. 11, 2015), 80 FR 14437 (Mar. 19, 2015); Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 75611 (Aug. 5, 2015), 80 FR 48963 (Aug. 14, 2015); Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 78321 (July 14, 2016), 81 FR 53545 (Aug. 12, 2016) (''2016 Regulation SBSR Adopting Release''); Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Person To Effect or Be Involved in Effecting Security-Based Swaps, Exchange Act Release No. 84858 (Dec. 19, 2018), 84 FR 4906 (Feb. 19, 2019); 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) (''Capital, Margin, and Segregation Adopting Release''); Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers, Exchange Act Release No. 87005 (Sept. 19, 2019), 84 FR 68550 (Dec. 16, 2019) (''Recordkeeping and Reporting Adopting Release''); Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements, Exchange Act Release No. 87780 (Dec. 18, 2019), 85 FR 6270 (Feb. 4, 2020) (''Cross-Border Amendments Release'').

[3] *See* Cross-Border Amendments Release, 85 FR at 6345–46. The first SBSDs were required to be conditionally registered with the Commission by November 1, 2021.

[4] *See* SEC Approves Registration of First Security-Based Swap Data Repository; Sets the First Compliance Date for Regulation SBSR (*available at: https://www.sec.gov/news/press-release/2021-80*). In addition, each registered security-based swap data repository (''SBSDR'') will be required to begin publicly disseminating security-based swap data as of February 14, 2022, which is the first Monday that is three months after the date that reporting began. *See* 2016 Regulation SBSR Adopting Release, 81 FR at 53608. Finally, the deadline for reporting certain historical security-based swaps to an SBSDR is two months after the date that public dissemination is required to begin (*i.e.,* April 14, 2022). *See* 2016 Regulation SBSR Adopting Release, 81 FR at 53610.

[5] *See* 15 U.S.C. 78i(j). Note that Section 9 of the Exchange Act erroneously contains two subsection (j)s.

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 to account for security-based swaps. For example, the Dodd-Frank Act amended the definition of ''security'' in Section 3(a)(10) of the Exchange Act [7] and Section 2(a)(1) of the Securities Act [8] 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), 10(b) and 17 CFR 240.10b–5 (''Rule 10b–5'') under the Exchange Act,[9] and Section 17(a) of the Securities Act.[10]

Moreover, the Dodd-Frank Act amended the definitions of ''purchase'' and ''sale'' in Section 2(a)(18) of the Securities Act,[11] the definitions of ''buy'' and ''purchase'' in Section 3(a)(13) of the Exchange Act,[12] and ''sale'' and ''sell'' in Section 3(a)(14) of the Exchange Act,[13] in the context of security-based swaps, to include the execution, termination, assignment, exchange, transfer, or extinguishment of rights or obligations. As a result of those changes, misconduct in connection with these actions will also be prohibited under Sections 9 and 10(b) of the Exchange Act and Rule 10b–5 thereunder, and Section 17(a) of the Securities Act.

Finally, the Dodd-Frank Act also amended the Exchange Act to explicitly authorize the Commission to require reporting of large security-based swap positions. Section 763(h) of the Dodd-Frank Act, entitled ''Position limits and position accountability for security-based swaps and large trader reporting,'' added Section 10B to the Exchange Act. In addition to providing the Commission with authority to establish position limits for security-based swaps, Section 10B(d) also provides the Commission with rulemaking authority to require reporting of large security-based swap positions. Specifically, Section 10B(d) authorizes the Commission to:

> . . . require any person that effects transactions for such person's own account or the account of others in any securities-based swap or uncleared security-based swap and any security or loan or group or narrow-based security index of securities or loans . . . to report such information as the Commission may prescribe regarding any position or positions in any security-based swap or uncleared security-based swap and any security or loan or group or narrow-based security index of securities or loans . . .[14]

On November 3, 2010, the Commission proposed for comment new Rule 9j–1, which would have prohibited the same categories of misconduct as Section 10(b) of the Exchange Act and Rule 10b–5 thereunder, and Section 17(a) of the Securities Act of 1933, in the context of security-based swaps, but would also have explicitly addressed misconduct that is in connection with the ''exercise of any right or performance of any obligation under'' a security-based swap.[15] In other words, the 2010 proposed rule would have applied to offers, purchases, and sales of security-based swaps in the same way that the general antifraud provisions apply to all securities, but also would have explicitly applied to the cash flows, payments, deliveries, and other ongoing obligations and rights that are specific to security-based swaps.[16]

The Commission has not yet finalized rules mandated by Section 9(j), nor has it proposed any reporting requirements pursuant to Section 10B(d) of the Exchange Act. The regulatory landscape for security-based swaps has changed since the Commission first proposed Rule 9j–1 in 2010. At the time, efforts to reform the global OTC derivatives markets, which had been set in motion in response to the 2008 financial crisis, had only begun, such that these markets were not yet subject to a comprehensive regulatory framework.[17] Since that time, however, regulators overseeing the world's primary OTC derivatives markets have made significant progress implementing reforms for OTC derivatives.[18] In addition to the progress made by the Commission in finalizing its Title VII rulemakings related to security-based swaps, the CFTC has largely completed its Title VII rulemakings related to swaps, including by adopting antifraud and anti-manipulation rules under the Commodity Exchange Act (''CEA'') to implement the Dodd-Frank Act's amendments to Section 6(c) of the CEA.[19] In light of the above, the Commission believes that now is an opportune time to move forward with the antifraud and manipulation rules required by Section 9(j) as well the rules contemplated by Section 10B(d). 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, in that they are tasked with designing and maintaining effective compliance systems, the Commission also is proposing an additional measure under Section 15F(h) of the Exchange Act to protect CCOs in the furtherance of those duties.[20]

B. Observations in the Credit Default Swap Market

In addition to the regulatory developments, there have been market developments. A number of press reports and academic articles since 2010

[6] *See id.*

[7] 15 U.S.C. 78c(a)(10).

[8] 15 U.S.C. 77b(a)(1).

[9] 15 U.S.C. 78j(b).

[10] 15 U.S.C. 77q(a).

[11] 15 U.S.C. 77b(a)(18).

[12] 15 U.S.C. 78c(a)(13).

[13] 15 U.S.C. 78c(a)(14).

[14] *See* 15 U.S.C. 78j–2(d).

[15] *See* 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 generally refer to Rule 9j–1 as we propose it here as the ''proposed rule'' or ''re-proposed Rule 9j–1.''

[16] *See* 2010 Rule 9j–1 Proposing Release, 75 FR at 68561–62.

[17] Commodity Futures Trading Commission and SEC Joint Report on International Swap Regulation, Jan. 31, 2012 (*available at: https://www.sec.gov/files/sec-cftc-intlswapreg.pdf*).

[18] *See* Financial Stability Board, OTC Derivatives Market Reforms: Note on implementation progress for 2010, Nov. 25, 2020 (*available at: https://www.fsb.org/wp-content/uploads/P251120.pdf*).

[19] 17 CFR 180.1 (''CFTC Rule 180.1'') implements the provisions of Section 6(c)(1) of the CEA by prohibiting, among other things, manipulative and deceptive devices employed intentionally or recklessly, regardless of whether the conduct in question was intended to create or did create an artificial price. CFTC Rule 180.1 also prohibits trading on the basis of material non-public information in breach of a pre-existing duty (established by another law or rule, agreement, understanding, or some other source) and trading on the basis of material non-public information that was obtained through fraud or deception. See 17 CFR 180.1. CFTC Rule 180.1(a) is modeled after Rule 10b–5 of the Exchange Act, although it contains some notable differences, such as its application to attempted fraud and manipulation. *Id.* 17 CFR 180.2 (''CFTC Rule 180.2''), promulgated pursuant to Section 6(c)(3) of the CEA and CFTC's general rulemaking authority, addresses price manipulation and, in line with Section 6(c)(3) of the CEA, 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.'' A violation of CFTC Rule 180.2 requires a showing of ''specific intent.'' *See* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 FR 41398, 41707 (Jul. 14, 2011) (''[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.'').

[20] 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.

have discussed manufactured credit events or other opportunistic strategies in the credit default swap (''CDS'') market.[21] Manufactured or other opportunistic CDS strategies can take a number of different forms but generally involve CDS buyers or sellers taking steps, with or without the participation of a company whose securities underlie, or are referenced by, a CDS (a ''reference entity''),[22] to avoid, trigger, delay, accelerate, decrease, and/or increase payouts on CDS.[23] Some examples reported by academics and the press include:

- 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).[24]
- The strategy above (as well as other strategies) can be combined with 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).[25]
- 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.[26]
- 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.[27]
- 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.[28]

In June 2019, the former SEC Chairman, together with the principals of the CFTC and the U.K. Financial Conduct Authority at the time, issued a public statement stating that the ''continued pursuit of various opportunistic strategies in the credit derivatives markets, including but not limited to those that have been referred to as 'manufactured credit events,' may adversely affect the integrity, confidence and reputation of the credit derivatives markets, as well as markets more generally'' (''2019 Joint Statement'').[29] Additionally, in April 2018 the Board of Directors of ISDA stated their belief that ''narrowly tailored defaults . . . could negatively impact the efficiency, reliability and fairness of the overall CDS market.'' [30] Following this statement, in March 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'').[31]

C. Overview of the Proposal

1. Re-Proposed Rule 9j–1

The Commission has decided to re-propose Rule 9j–1. As described in detail below, re-proposed Rule 9j–1 follows the same general approach as the 2010 proposed rule in that it would prohibit the same categories of misconduct as Section 10(b) of the Exchange Act and Rule 10b–5 thereunder, and Section 17(a) of the Securities Act of 1933 in the context of security-based swaps, including misconduct that is in connection with the exercise of any right or performance of any obligation under a security-based swap.[32] Unlike the 2010 proposed rule, however, this new proposal also includes an anti-manipulation provision similar to 17 CFR 108.2 (''CFTC Rule 180.2'').[33] Further, re-proposed Rule 9j–1 would provide that: (1) A person with material non-public information about a security cannot avoid liability under the securities laws by making purchases or sales in the security-based swap (as opposed to purchasing or selling the underlying security), and (2) a person cannot avoid liability under Section 9(j) or re-proposed Rule 9j–1 in connection with a fraudulent scheme involving a security-based swap by instead making purchases or sales in the underlying

[21] *See, e.g.,* Gina-Gail S. Fletcher, Engineered Credit Default Swaps: Innovative or Manipulative? 94 N.Y.U. L. Rev. 1073 (2019); *see also* Andras Danis & Andrea Gamba, Dark Knights: The Rise in Firm Intervention by CDS Investors, Ga. Inst. Of Tech. Scheller Coll. of Bus. Working Paper, Paper No. 3479635 & WBS Fin. Grp. Working Paper, Paper No. 265 (Nov. 2019) (*available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3479635*); *see also* 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. 26–27 (Nov. 2018) (*available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3302816*).

[22] A security-based swap, including a CDS contract, may reference a number of different types of securities, including instruments of indebtedness, indices, interest rates, quantitative measures, or other financial or economic interests (each a ''reference obligation'').

[23] In order to cash settle any CDS contract that relies on the International Swaps and Derivatives Association (''ISDA'') standard documentation, a Credit Derivatives Determinations Committee (''DC'') must make a determination that a defined default event (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. Since a protection buyer has the right to deliver any of the deliverable obligations specified on the list, it is in the protection buyers' interest to deliver into the auction the cheapest deliverable obligation; 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, Jan. 11, 2012, 5 (*available at: https://doc.research-andanalytics.csfb.com/docView?language=ENG&source=emfromsendlink&format=PDF&document_id=803733390&serialid=FWHCx3yCrSE3FoEvAbEKa6fRKhqLoKs0jL1gR5W2Dfs%3D*).

[24] *See* Hu, *supra* note 21 at 26–27.

[25] *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/divisionsstatement 042418*).

[26] *See* Hu, *supra* note 21 at 22–26.

[27] *See* Fletcher, *supra* note 21 at 1101.

[28] *See* Fletcher, *supra* note 21 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?*).

[29] *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*).

[30] *See* ISDA Board Statement on Narrowly Tailored Credit Events (April 11, 2018) (*available at: ISDA Board Statement on Narrowly Tailored Credit Events—International Swaps and Derivatives Association*).

[31] *See* Proposed Amendments to the 2014 ISDA Credit Derivatives Definitions Relating to Narrowly Tailored Credit Event (Mar. 6, 2019) (*available at: https://www.isda.org/2019/03/06/proposed-amendments-to-the-2014-isda-credit-derivatives-definitions-relating-to-narrowly-tailored-credit-events/*). On September 19, 2019, an update to the 2019 Joint Statement was issued. *See* Update to Joint Statement (Sept. 19, 2019) (*available at: https://www.sec.gov/news/public-statement/update-june-2019-joint-statement-opportunistic-strategies-credit-derivatives*). The updated statement welcomed ISDA's efforts, but also noted that 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.

[32] *See* re-proposed Rule 9j–1(a) and (e).

[33] *See* re-proposed Rule 9j–1(b).

security (as opposed to purchases or sales in -the security-based swap).[34]

The Commission recognizes that CDS buyers and sellers regularly engage in legitimate interactions with reference entities, and often offer critical means of restructuring and funding for reference entities. Moreover, we also 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 Commission preliminarily believes the proposal is sufficiently tailored to balance these concerns but, in section II.E below, is also soliciting comment on how it can address manufactured or other opportunistic strategies that involve fraudulent, deceptive, or manipulative activity, or that involve such quotations as are fictitious, without impairing the proper functioning of the security-based swap markets or other securities markets.

Further, the scope of re-proposed Rule 9j–1 is not limited to CDS. 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 swaps, including equity and non-CDS debt security-based swaps. Manipulation of the underlying reference security can affect the pricing of an equity or debt security-based swaps, 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 swaps transactions that are effected over the internet, there is a potential for trading software to distort pricing and payouts on security-based swaps.[35] Finally, to the extent an opportunistic strategy alters the operations of a reference entity, counterparties to any security-based swap based on that reference entity could be impacted; the potential harm is not limited to CDS holders. As a result, re-proposed Rule 9j–1 applies to all transactions in security-based swaps, consistent with the 2010 proposed rule.

2. Proposed Rule 15Fh–4(c)

The Commission also is proposing 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 proposing Rule15Fh–4(c) which would make 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.

3. Proposed Rule 10B–1

Finally, the Commission also recognizes that transparency can be beneficial to market participants so that they can act in an informed manner to protect their own interests. One example involves what some legal observers refer to as ''net-short debt activism''—where a market participant with a large CDS position and a controlling voting interest in the debt of a reference entity votes against its interest as a debt holder to ensure that a credit event occurs (such as by blocking a restructuring or voting against curing a technical default under the terms of a loan).[36] In such instances, both the Commission and relevant market participants—particularly issuers of the underlying debt securities—could benefit from having access to information that may indicate that one or more market participants has a financial incentive to take an action that would be harmful to the issuer, which in turn could impact the issuer's other security holders.[37] In particular, such notice would provide the relevant parties with the ability to take appropriate action to limit any potential harmful consequences. Given such benefits to the market, which may accrue even where the facts and circumstances of a particular situation are not indicative of potentially fraudulent, manipulative, or deceptive conduct, the Commission believes that public reporting of large CDS positions would help to provide such advance notice.

Additional transparency regarding large security-based swap positions also could alert market participants, including counterparties, as well as issuers of securities and their security holders, to the risk posed by the concentrated exposure of a counterparty. Such transparency also could enhance risk management by security-based swap counterparties and inform pricing of the security-based swaps. For example, if a single counterparty has a $5 billion security-based swap position distributed equally among five different dealers on the same underlying equity security, public reporting of that security-based swap position would alert each dealer to the total exposure of the reporting counterparty. In the event of an issue involving the underlying security or the counterparty's ability to make a payment on the security-based swaps composing the large position, some or all of those dealers could then take actions to protect their positions, such as increasing their hedges against the relevant security-based swaps or calling for additional margin, if permitted. Knowledge of the total position of a counterparty also may inform a dealer's actions in the event that the counterparty defaults on its obligations under the security-based swap.

Finally, transparency about security-based swap positions could play an important role in protecting market integrity, including by providing the Commission and other regulators with access to information that may indicate that a person (or a group of persons) is building up a large security-based swap position, which may be relevant for a number of reasons, as discussed in greater detail in section III. As previously discussed, the manufactured or other opportunistic strategies that have been reported to have taken place in the CDS markets take on a variety of

[34] *See* re-proposed Rule 9j–1(c) and (d).

[35] *See e.g.,* SEC Investor Alert: Binary Options Fraud available at: *https://www.investor.gov/protect-your-investments/fraud/types-fraud/binary-options-fraud.* (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 Investor 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 Investor 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.

[36] *See* Joshua A. Feltman, Emil A. Kleinhaus, and John R. Sobolewski, Wachtell, Lipton, Rosen & Katz, The Rise of Net-Short Debt Activism, Harvard Law School Forum on Corporate Governance and Financial Regulation (Aug. 7, 2018) (*available at: https://corpgov.law.harvard.edu/2018/08/07/the-rise-of-the-net-short-debt-activist/*). *See also* Matt Levine, Aurelius Broke Windstream's Bonds to Save Them, Bloomberg View (Feb. 27, 2019).

[37] Harm to the issuer could lead to harm to its employees, customers, and business partners, among others. Any one of these indirect effects could create further harm to the issuer and its security holders.

forms. Although some of those strategies may have involved fraudulent or manipulative conduct, including those that involve parties acting to artificially inflate CDS payments, others do not necessarily constitute prohibited activity. The common thread to all of those strategies, however, is one or more parties taking affirmative steps to avoid, trigger, delay, accelerate, decrease, and/or increase payouts on CDS.[38] Given the importance of the CDS market and its interconnectedness with the underlying debt securities that CDS may be used to hedge, the Commission believes that additional transparency in the CDS market can help to ensure that it remains fair, orderly, and efficient. For similar reasons, such transparency also should benefit the market for other types of security-based swaps.

Accordingly, the Commission has decided to utilize its rulemaking authority under Section 10B of the Exchange Act to propose new Rule 10B–1, which would be a large trader position reporting rule for security-based swaps. Specifically, proposed Rule 10B–1 would require public reporting of, among other things: (1) Certain large positions in security-based swaps; (2) positions in any security or loan underlying the security-based swap position; and (3) positions in any other instrument relating to the underlying security or loan or group or index of securities or loans. As described in detail below, proposed Rule 10B–1 would, among other things, include a specific quantitative threshold for when public reporting is required.

The Commission recognizes that market participants are already subject to the requirements of 17 CFR 242.900 through 242.909 (''Regulation SBSR''), which governs regulatory reporting of security-based swap transactions to security-based swap data repositories (''SBSDRs'') and public dissemination of some of that transaction data pursuant to Section 13(m) of the Exchange Act.[39] Although both sets of requirements are intended to provide greater transparency in the security-based swap market, certain differences between the two highlight the need to propose Rule 10B–1. For example, pursuant to the statutory authority in Section 13(m)(1), Regulation SBSR requires real-time public reporting to SBSDRs and public dissemination of security-based swap *transaction* data but not of *position* data as is contemplated by Section 10B and proposed Rule 10B–1.[40] Although registered SBSDRs are required to establish, maintain, and enforce written policies and procedures reasonably designed to calculate positions for all persons with open security-based swaps for which the SBSDR maintains records,[41] they are not required to make those reports public.[42] As a result, any public position reporting pursuant to Regulation SBSR would need to be completely anonymous with respect to *both* the person building up large, concentrated security-based swap positions, and each of its counterparties. Finally, Regulation SBSR only requires reporting and public dissemination of security-based swaps, in contrast to Section 10B, which authorizes the Commission to require reporting of positions in both security-based swaps and *related* securities.[43] The Commission believes that requiring reporting of related securities serves an important function in allowing both the Commission and the public to develop a greater understanding of the impact that a large security-based swap position can have on the broader securities markets.

[38] *See* Fletcher, *supra* note 21 at 1098 (''[I]t is evident that engineered CDS transactions are unfair, create the perception of the market being rigged, and undermine the integrity of the market. . . . Fundamentally, parties enter into CDS expecting that the ultimate determination of whether the contract pays off rests with market forces, over which neither party has control. However, when a counterparty interferes and skews the outcome of the CDS contract to her benefit, she undercuts her counterparties' reasonable expectations and unjustly transfers wealth from her counterparty to herself.'').

[39] *See supra* note 4 and accompanying text (explaining that transaction reporting for security-based swaps has been required since November 8, 2021, with public dissemination to begin on February 14, 2022).

[40] *See, e.g.,* Section 13(m)(1)(C) of the Exchange Act, which provides that ''[t]he Commission is authorized to provide by rule for the public availability of security-based swap transaction, volume, and pricing data'' subject to certain conditions and requirements. 15 U.S.C. 78m(m)(1)(C).

[41] *See* 17 CFR 240.13n–5(b)(2).

[42] In fact, Section 13(m)(1)(C)(iii) of the Exchange Act provides that any Commission rulemaking pursuant to Section 13(m) (*i.e.,* Regulation SBSR) ''shall require real-time public reporting for [security-based swap] transactions, in a manner that does not disclose the business transactions and market positions of any person.'' *See* 15 U.S.C. 78m(m)(1)(C)(iii). By contrast, Section 10B(d), which is titled ''Large Trader Reporting,'' does not contain a limitation on disclosing the identity of security-based swap counterparties in connection with security-based swap *position* reporting. As discussed in section III, however, a person subject to the reporting requirements of proposed Rule 10B–1 would have to report its own identity and the size of its aggregate security-based swap position, but the person would not be required to report any information about its counterparties, including their identities.

[43] *See* supra note 14 and accompanying text.

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

A. Prior Commission Action

As initially proposed in 2010, Rule 9j–1 would have prohibited the same categories of misconduct addressed by Section 10(b) of the Exchange Act [44] and Rule 10b–5 thereunder,[45] as well as Section 17(a) of the Securities Act,[46] but specifically in the context of security-based swaps. The 2010 proposed rule explicitly reached misconduct in connection with the ongoing payments and deliveries that are typical of security-based swaps, which occur throughout the life of the security-based swap.[47] Specifically, the 2010 proposed rule would have made it unlawful for any person, directly or indirectly, in connection with the offer, purchase or sale of any security-based swap, in the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance: (a) To employ any device, scheme, or artifice to defraud or manipulate; (b) to knowingly or recklessly make any untrue statement of a material fact, or to knowingly or recklessly 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; (c) 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 (d) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[48]

Most commenters on the 2010 proposed rule generally supported the Commission's goal of adopting antifraud standards to ensure the integrity of the security-based swap market.[49] Some commenters expressed strong support for the 2010 proposed rule, stating that the rule would encourage investor confidence in the security-based swap market and would help ensure that the Commission has the ability to respond through enforcement mechanisms to

[44] 15 U.S.C. 78j(b).

[45] 17 CFR 240.10b–5.

[46] 15 U.S.C. 77q(a).

[47] 2010 Rule 9j–1 Proposing Release, 75 FR at 68561.

[48] 2010 Rule 9j–1 Proposing Release, 75 FR at 68568.

[49] The comment letters can be found at: *http://www.sec.gov/comments/s7-32-10/s73210.shtml.*

misconduct interfering with the independence and proper functioning of the market.[50] In addition, one commenter specifically requested that the Commission require disclosure of debt security-based swap positions.[51]

However, some commenters stated that the 2010 proposed rule exceeded the Commission's authority by addressing activities involving the exercise of any rights and performance of any obligations during the life of a security-based swap, as opposed to addressing only misconduct taking place in connection with the ''purchase'' and ''sale'' of a security-based swap.[52] Those commenters all generally argued that unless modified, the 2010 proposed rule would have a negative impact or chilling effect on the security-based swap market by unintentionally prohibiting the legitimate exercise of rights and performance of obligations under a security-based swap and by leading to costly unintended consequences. Section II.B.2. includes a discussion of the concerns raised by these commenters.

B. Scope of Re-Proposed Rule 9j–1

1. General Antifraud and Anti-Manipulation Provisions

The general antifraud and anti-manipulation provisions in re-proposed Rule 9j–1(a) would make it unlawful for any person, directly or indirectly, (i) to purchase or sell, or attempt to induce the purchase or sale of, any security-based swap; [53] (ii) to effect any transaction in, or attempt to effect any transaction in, any security-based swap; (iii) 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 (iv) 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; or

(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; or

(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 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.

Like the 2010 proposed rule, the current proposal generally relies on language from Section 10(b) of the Exchange Act [54] and Rule 10b–5 thereunder,[55] and Section 17(a) of the Securities Act,[56] as it relates to the specific types of fraudulent, manipulative, or deceptive conduct that re-proposed Rule 9j–1(a) is designed to address. In addition, re-proposed Rule 9j–1(a) describes the particular types of activity that would be covered by the rule, to the extent that a person engages in specified types of fraudulent, manipulative, or deceptive conduct in connection with such activities.[57] Specifically, the proposed rule would apply not only to the ''purchase'' or ''sale'' of security-based swaps, as such terms are defined in the Exchange Act,[58] but also to: (1) Effecting transactions, or attempts to effect transactions in, security-based swaps, (2) taking actions to exercise any right or actions related to performance of any obligation pursuant to any security-based swap including any payments, deliveries, rights, or obligations or alterations of any rights thereunder, or (3) terminating (other than on its scheduled maturity date) or settling any security-based swap, in connection with which such person engages in the specified fraudulent, manipulative, or deceptive conduct.

With respect to the operative paragraphs in re-proposed Rule 9j–1(a) describing the fraudulent, manipulative or deceptive conduct that the rule prohibits, those provisions have been structured to combine the antifraud and anti-manipulation provisions in Rule 10b–5 that apply to all securities (including security-based swaps) with the additional antifraud and anti-manipulative authority specific to security-based swaps provided to the Commission in Section 9(j). For example, re-proposed Rule 9j–1(a)(1) would explicitly 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) relies on the statutory authority in Section 9(j) of the Exchange Act, the Commission has determined to retain the language from the 2010 proposed rule that is based on an existing Exchange Act rule.

[50] *See, e.g.,* Letter from Laurel Leitner, Council for Institutional Investors, dated Dec. 16, 2010, at 1–2; Letter from Dennis Kelleher and Wallace Turbeville, Better Markets, dated Dec. 23, 2010, at 1–2; Letter from Chris Bernard, dated Nov. 21, 2010, at 1.

[51] *See* Letter from Suzanne H. Shatto, dated Jan. 27, 2011.

[52] *See* Letter from Stuart J. Kaswell, Managed Funds Association (''MFA''), dated Dec. 23, 2010 (''December 2010 MFA Comment Letter'') at 2–10; Letter from Stuart J. Kaswell, MFA, dated Mar. 29, 2011 (''March 2011 MFA Comment Letter'') at 3–9; Letter from Kenneth E. Bentsen, Jr., Securities Industry and Financial Markets Association (''SIFMA'') and Robert G. Pickel, ISDA, dated Dec. 23, 2010 (''SIFMA/ISDA Joint Comment Letter'') at 9–10, 13; Letter from Kenneth E. Bentsen, Jr., SIFMA, dated July 8, 2011 (''July 2011 SIFMA Comment Letter'') at 2–8; and Letter from R. Bram Smith, Loan Syndications and Trading Association (''LSTA''), dated Dec. 23, 2010 (''LSTA Comment Letter'') at 2–10.

[53] *See* proposed Rule 9j–1(e), which provides 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. 15 U.S.C. 78c(a)(13) and (14).

[54] 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.'' *See* 15 U.S.C. 78j(b).

[55] 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.'' *See* 17 CFR 240.10b–5.

[56] 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.'' *See* 15 U.S.C. 77q(a). In contrast to the 2010 proposed rule, the current proposal does not contain a provision based on Section 17(a)(2) of the Securities Act. Given that the current proposal itself

[57] *See* proposed Rule 9j–1(a). The introductory language in paragraph (a) follows Section 9(j) of the Exchange Act, in that it would prohibit specified activities *in connection with* which any person engages in the prohibited conduct set forth in paragraphs (1) through (4). By contrast, the corresponding language in the 2010 proposed rule followed the format used in Section 10(b) and applied solely to conduct that is *in connection with* the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance. The re-proposed language is intended to more closely track the authorizing statutory language in Section 9(j), and to make clear that under the proposed rule an activity would only be unlawful when done in connection with fraudulent, manipulative, or deceptive conduct.

[58] *See* proposed Rule 9j–1(e).

of the Exchange Act,[59] Rule 10b–5 thereunder,[60] and Section 17(a)(1) of the Securities Act,[61] the inclusion of ''manipulate'' and the extension of the prohibition to include an ''attempt'' to employ any device, scheme, or artifice to defraud or manipulate comes directly from the statutory authority in Section 9(j).[62] Paragraph (a)(2) of re-proposed Rule 9j–1, which prohibits the making of material misstatements or omissions, also is based on Rule 10b–5 and also contemplates an attempt to make a material misstatement or omission.

Finally, paragraphs (a)(3) and (4) of re-proposed Rule 9j–1 are based on Sections 17(a)(2) and (3) of the Securities Act.[63] Again, however, the re-proposed rule would now extend those provisions to attempted conduct, such that they would prohibit a person from (i) 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; and (ii) 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 person.

As the Commission explained in the 2010 Rule 9j–1 Proposing Release, the provisions described above have been designed generally to prohibit a range of fraudulent, manipulative and deceptive conduct in the security-based swap market, such as, among other things, ''engaging in fraudulent and deceptive schemes in order to increase or decrease the price or value of a security-based swap, or disseminating false or misleading statements that affect or otherwise manipulate the price or value of the reference underlying of a security-based swap for the purpose of benefiting such person's position in the security-based swap.'' [64] Re-proposed Rule 9j–1(a) also would prohibit, for example, disseminating false financial information or data in connection with the sale of a security-based swap or insider trading in a security-based swap. It also would prevent misconduct that affects the market value of the security-based swap for purposes of posting collateral or making payments or deliveries under such security-based swap.[65]

Re-proposed Rule 9j–1(a) also would prohibit fraudulent conduct in connection with a security-based swap that affects the value of cash flow, payments, or deliveries, such as by triggering the obligation of a counterparty to make a large payment or to post additional collateral. It would also prohibit a person from taking fraudulent or manipulative action with respect to the reference entity or asset of the security-based swap that triggers the exercise of a right or performance of an obligation or affects the payments to be made.[66]

Re-proposed Rules 9j–1(a)(1) and (2), consistent with Section 10(b) of the Exchange Act and Rule 10b–5 thereunder,[67] and Section 17(a)(1) of the Securities Act,[68] would require scienter.[69] In contrast, re-proposed Rules 9j–1(a)(3) and (4) would not require scienter consistent with Sections 17(a)(2) and (3) of the Securities Act.[70]

While both re-proposed Rules 9j–1(a)(2) and (3) would prohibit material misstatements and omissions,[71] they would address different levels of culpability.[72] Specifically, re-proposed

[59] *See supra* note 54.

[60] *See supra* note 55.

[61] *See supra* note 56.

[62] *See supra* note 5 and accompanying text. The application to attempted conduct also appears in other places in the Exchange Act and the rules and regulations thereunder. For example, Section 15(c)(1)(A) of the Exchange Act makes it unlawful for any broker-dealer ''to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills), or any security-based swap agreement by means of any manipulative, deceptive, or other fraudulent device or contrivance.'' 15 U.S.C. 78o(c)(1)(A). *See also* Commission Guidance Regarding Prohibited Conduct in Connection with IPO Allocations, Exchange Release No. 51500 (Apr. 7, 2005), 70 FR 19672, 19673 (Apr. 13, 2005) (''Regulation M applies to 'attempts,' thus proscribing a distribution participant's conduct irrespective of whether it actually results in market activity by others. It is the inducement or the attempt to induce during the restricted period that Regulation M prohibits.'') (internal citations omitted).

[63] *See supra* note 56.

[64] *See* 2010 Rule 9j–1 Proposing Release, 75 FR at 68569.

[65] *See id.*

[66] *See id.*

[67] To state a claim under Section 10(b) of the Exchange Act and Rule 10b–5, 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).

[68] 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).

[69] The language in the 2010 proposed rule that corresponds to re-proposed Rule 9j–1(a)(2) included the phrase ''knowingly or recklessly'' when describing the prohibited conduct. The Commission has not included such phrase in the current proposal to remain consistent with similar language in Rule 10b–5. *See* 17 CFR 240.10b–5(b).

[70] 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. *See also* Section 206(2) of the Advisers Act, which makes it unlawful for an investment adviser to engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client. 15 U.S.C. 80b–6(2). The Commission is not required to demonstrate that an adviser acted with scienter in order to prove a Section 206(2) violation. *SEC* v. *Steadman,* 967 F.2d 636, 643 (D.C. Cir. 1992) (*citing SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 191–92 (1963)).

[71] 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).

[72] In addition to differences in the standard of care, there are additional deviations between re-proposed 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

Continued

Rule 9j–1(a)(2) would 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, re-proposed Rule 9j–1(a)(3) would extend 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).

The Commission recognizes that two commenters to the 2010 proposed rule opposed not requiring scienter with respect to paragraphs (3) and (4) of re-proposed Rule 9j–1(a) (which were paragraphs (c) and (d) in the 2010 proposed rule). Specifically, SIFMA and ISDA argued that applying a negligence standard to those provisions did not account for the unique aspects of the security-based swap market and, when ''coupled with the rights and responsibilities provision and enforcement exposure for omissions of disclosure, potentially would make illegal a wide range of ordinary course activities that may relate to an SBS transaction.'' [73] Those commenters explained that ''[s]ubjecting every trading decision or payment under an SBS to an enforcement claim that someone knew or should have known that the action would operate as a fraud or deceit on a person could potentially deter many parties from entering into SBS, increase their cost and have other distorting effects on the markets.'' [74]

Although the Commission recognizes the concerns raised by these commenters, we have determined to re-propose Rule 9j–1(a) using the same standards of care as proposed in 2010. As previously noted, each of those provisions is based on an existing statutory and regulatory provision that is supported by a large body of case law.[75] In that respect, the Commission does not believe it is appropriate to treat negligent conduct that would have been deemed a violation under the existing antifraud and anti-manipulation provisions of the Federal securities laws and the rules and regulations thereunder as not violative under proposed Rule 9j–1(a) solely because security-based swaps contracts by their nature may require the counterparties to take ongoing actions to satisfy their rights and obligations. Such an approach would be particularly untenable in light of the fact that security-based swaps are included in the definition of ''security'', and therefore are also subject to such general antifraud and anti-manipulation provisions, including the relevant non-scienter-based prohibitions. To the extent that there is any overlap between re-proposed Rule 9j–1(a) and those existing provisions, introducing a different standard of care would create unnecessary confusion.

Moreover, having two nearly identical antifraud and anti-manipulation rules (*e.g.,* re-proposed Rule 9j–1(a)(1) and Rule 10b–5(b)) that are subject to two different standards of care—one for security-based swaps and one for other types of securities—is likely to lead to confusion among market participants and could 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 is not able to be rationalized by the differences in the underlying instruments. Although the Commission preliminarily believes the re-proposed rule is not overly broad, in section II.E below, the Commission is requesting comment on whether there are potential ways to minimize the impact of the rule on non-fraudulent and non-manipulative ordinary course activities in connection with security-based swap transactions.

2. ''Purchases'' and ''Sales'' in the Context of Security-Based Swaps and Limited Safe Harbor for Certain Limited Actions

As previously noted, a number of commenters on the 2010 proposed rule argued that the Commission exceeded its statutory authority in the course of proposing Rule 9j–1 by explicitly applying the rule to activities involving the exercise of any rights and performance of any obligations during the life of a security-based swap, as opposed to limiting the proposed rule to misconduct taking place in connection with the ''purchase'' and ''sale'' of a security-based swap.[76] For example, MFA argued that the Commission exceeded delegated authority in proposing that the prohibitions in Rule 9j–1 extend ''beyond purchases and sales to acts and omissions occurring during the term of a security-based swap,'' explaining that ''[i]n clarifying the terms 'purchase' and 'sale' in the security-based swap context, Congress chose specifically not to include ongoing obligations, which are dictated by the contract between the two parties underlying the security-based swap and which bear no relation to execution, termination, assignment, exchange and transfer or extinguishment of rights.'' [77] MFA also expressed its view that ''Section 763(g) of Dodd-Frank is aimed at preventing fraudulent, deceptive, or manipulative acts in connection with: (i) The entry into a securit[y]-based swap; (ii) the novation or assignment of a securit[y]-based swap; and (iii) the unwind of a securit[y]-based swap,'' and that the statute should not be read to encompass the settlement of a security-based swap, or the ongoing payments or collateral postings that take place throughout the life of the transaction.[78]

Similarly, SIFMA and ISDA expressed the view that ''[t]he rulemaking authority provided by Section 763(g) only extends to transactions, acts, practices, or courses of business in connection with (i) effecting any transaction in [a security-based swap] and (ii) inducing or attempting to induce the purchase or sale of [a security-based swap].'' [79] SIFMA also separately shared its concerns 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 be particularly problematic in the event that a counterparty came into possession of material non-public information relating to the underlying security, even if such information had no bearing on such non-volitional actions.[80] Further, the LSTA argued that

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)'').

[73] *See* SIFMA/ISDA Joint Comment Letter at 12.

[74] *See* SIFMA/ISDA Joint Comment Letter at 3.

[75] *See supra* notes 67–71 and accompanying text.

[76] *See supra* note 52 and accompanying text.

[77] *See* December 2010 MFA Letter at 2–3. MFA provided examples of the types of ongoing obligations that it believed should not be covered by the rule, which included, among other things, certain periodic or other types of payments under the terms of the security-based swap as well as many forms of collateral or margin payments, and related obligations.

[78] *See* March 2011 MFA Comment Letter at 3–6.

[79] *See* SIFMA/ISDA Joint Comment Letter at 13.

[80] *See* July 2011 SIFMA Comment Letter at 2–7. SIFMA also requested that proposed Rule 9j–1 be modified to include a safe harbor, such as one that is similar to Rule 10b5–1(c)(2), which provides that an entity may demonstrate that a purchase or sale of securities is not ''on the basis of'' material non-public information if the person demonstrates that: (i) The individual making the investment decision on behalf of the person to purchase or sell the securities was not aware of the information; and (ii) the entity 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 violate the

the 2010 proposed rule would ''create uncertainty that undermines investors' willingness to enter [the security-based swap] market,'' explaining 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 it may take that could affect each such payment, delivery, obligation or right as well as to track changes in its positions in the security-based swap and reference underlying.'' [81]

The Commission has carefully considered these comments, but disagrees with the narrow interpretation of the terms ''purchase'' and ''sale'' when used in the context of security-based swaps, as espoused by commenters. Specifically, the Commission does not believe that the definitions of ''purchase'' and ''sale'' in Section 2(a)(18) of the Securities Act, the definitions of ''buy'' and ''purchase'' in Section 3(a)(13) of the Exchange Act, and the definitions of ''sale'' and ''sell'' in Section 3(a)(14) of the Exchange Act are limited to actions involving *all* of the rights and obligations under a security-based swap. Rather, the Commission believes that those definitions incorporate partial executions, terminations, assignments, exchanges, transfers, or extinguishments of rights or obligations. Put another way, those definitions incorporate actions that have an impact on some, but not all, rights and obligations, such as a margin payment that represents only part of what one counterparty owes the other.

In addition, Congress could have specifically limited the statutory definitions of ''purchase'' or ''sale'' to actions involving *all* of the rights and obligations under a security-based swap, and the Commission, therefore, does not believe it necessary to apply limitations to those definitions that do not appear in the statute given that even partial payments or deliveries over the course of a security-based swap are likely to be meaningful to most security-based swap transactions. Accordingly, we continue to believe the statute provides the Commission with authority to make explicit the liability of persons that engage in misconduct to trigger, avoid, or affect the value of ongoing payments or deliveries as a means reasonably designed to prevent fraud, manipulation, and deception in connection with security-based swap transactions.

To be clear, the Commission is not taking the position that every payment or delivery made during the course of a security-based swap transaction is itself a purchase or sale of a security-based swap under the applicable statutory authority. Rather, fraudulent or manipulative conduct would be in connection with the purchase or sale of a security-based swap if it either alters any material terms of the security-based swap (as set forth in the applicable trading relationship documentation) or 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. The Commission took a similar position when it defined certain Title VII terms, including ''swap'' and ''security-based swap,'' in a joint release with the CFTC, explaining that ''[i]f the material terms of a Title VII instrument are amended or modified during its life based on an exercise of discretion and not through predetermined criteria or a predetermined self-executing formula, the Commissions view the amended or modified Title VII instrument as a new Title VII instrument.'' [82] If a party engages in fraudulent or manipulative conduct that impacts the amount of payment or delivery in a way that is materially different from the amount a reasonable person would have expected to pay, deliver, or receive (or where such person would not have expected a payment or delivery to be required at all), such actions would be a new purchase or sale of the security-based swap. For example, and without limitation, such a scenario could involve a counterparty misstating certain information about a transaction (or any related transactions) resulting in a missed or late payment or loss of an opportunity to request additional collateral under a security-based swap.

Moreover, even if those statutory definitions were interpreted narrowly, the Commission's rulemaking authority under Section 9(j) of the Exchange Act to adopt prophylactic rules is not limited solely to purchases and sales of security-based swaps.[83] Section 9(j) of the Exchange Act 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.'' [84] Without limiting what is already covered by Section 9(j), the Commission is using that statutory authority to prohibit actions 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 each case so long as those actions are taken in connection with fraud, manipulation, or deception. The Commission believes that by prohibiting actions that directly impact a counterparty's rights and obligations under a security-based swap—when such actions are in connection with specified fraudulent, manipulative, or deceptive conduct—re-proposed Rule 9j–1 represents a means reasonably designed to prevent fraud, manipulation, and deception in the security-based swap market.

Furthermore, in the course of using its rulemaking authority under Section 9(j), the Commission looked not only to the antifraud and anti-manipulation provisions in Section 10(b) of the Exchange Act, Rule 10b–5 thereunder, and Section 17(a) of the Securities Act, but also to the operative provisions of Section 9(j) itself, which makes it unlawful ''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

laws prohibiting trading on the basis of material non-public information. Such policies and procedures may include those that restrict any purchase, sale, and causing any purchase or sale of any security as to which the person has material non-public information, or those that prevent such individuals from becoming aware of such information. *See* 17 CFR 240.10b5–1(c)(2).

[81] *See* LSTA Comment Letter at 2–8. As an example, the LSTA noted its concern that a decision to allow a borrower to avoid a bankruptcy filing or payment default could be construed as manipulation in connection with the subsequent exercise of a right or performance of an obligation (whether such action is volitional or non-volitional).

[82] *See* Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208, 48286 (Aug. 13, 2012) (''Products Release'').

[83] *See, e.g., U.S.* v. *O'Hagan,* 521 U.S. 642 (1997) (''[a] prophylactic measure, because its mission is to prevent, typically encompasses more than the core activity prohibited''). In *O'Hagan,* the Supreme Court held that under Section 14(e) of the Exchange Act (which includes the same ''reasonably designed to prevent fraudulent activity'' rulemaking language as Section 763(g) of the Dodd-Frank Act) the Commission may prohibit acts not themselves fraudulent under the common law or Section 10(b), provided that the prohibition is ''reasonably designed to prevent . . . acts and practices [that] are fraudulent.''

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

a fraud or deceit upon any person.'' At a minimum, that provision prohibits fraud, manipulation, or deception in the context of both inducements or attempts to induce the purchase or sale of a security-based swap, and effecting security-based swap transactions. As the Commission has previously explained in other contexts, ''effecting'' transactions in securities has been interpreted broadly and includes more than just executing trades or forwarding orders for execution.[85] Generally, effecting securities transactions also can include, for example, participating in the transactions through a number of activities such as screening potential participants in a transaction for creditworthiness, facilitating the execution of a transaction, and handling customer funds and securities.[86]

As discussed above, we disagree with the narrow interpretation of the statutory changes to the definitions of ''purchase'' and ''sale'' in the context of a security-based swap, as suggested by some commenters. That said, the Commission is sensitive to the operational concerns raised by commenters in response to the 2010 proposed rule and is therefore proposing two limited safe harbors from re-proposed Rule 9j–1(a) to address situations when a counterparty to a security-based swap is required to take certain actions while in possession of material non-public information.[87]

Specifically, re-proposed Rule 9j–1(f)(1) would provide that a person would not be liable under re-proposed Rule 9j–1(a) solely for reason of being aware of material non-public information while taking certain actions, the first of which includes actions taken 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 non-public information; and (2) that the entry into, and the terms of, the security-based swap are themselves not a violation of any provision of re-proposed Rule 9j–1(a).[88] The Commission believes that limiting the safe harbor to circumstances where the activity is taken in accordance with the written agreements governing the security-based swap would help to ensure that such action is taken in the ordinary course of the transaction. Further, the safe harbor would apply only so long as the entry into, and the terms of, the security-based swap do not otherwise violate re-proposed Rule 9j–1.

As a result, the proposed safe harbor would generally apply to, for example, 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 non-public information, so long as both actions are explicitly required by the terms of the transaction and documented in writing. However, the safe harbor 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.

The second proposed safe harbor would apply to transactions effected pursuant to certain types of compression exercises. Specifically, proposed Rule 9j–1(f)(2) would provide that a person would not be liable under re-proposed Rule 9j–1(a) solely for reason of being aware of material non-public information when effecting security-based swap transactions pursuant to a bilateral portfolio compression exercise (as defined in 17 CFR 240.15Fi–1(a) (''Rule 15Fi–1(a)'') of the Exchange Act) or a multilateral portfolio compression exercise (as defined Rule 15Fi–1(j)) so long as: (1) 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 the methodology used in the exercise, and (2) 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.[89]

As the Commission explained when it adopted portfolio compression requirements for SBS Entities, portfolio compression generally refers to a post-trade processing exercise that allows two or more market participants to eliminate redundant derivatives transactions within their portfolios in a manner that does not change their net exposure, and is intended to help market participants manage their post-traded risk.[90] For example, reducing the number of outstanding contracts provides important operational benefits and efficiencies for market participants in that there are fewer open contracts to

[85] *See* Registration Adopting Release, 80 FR at 48976, n. 99 (citing, for example, 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)).

[86] *See id.*

[87] Specifically, in its comment letter on the 2010 proposed rule, SIFMA explained that ''[u]nder the proposed rule, the counterparty would be required to disclose the [material non-public information] or abstain from performing its obligations under the contract, even though the [material non-public information] plays no role in its obligation to make payment. Requiring parties to ''disclose or abstain'' [material non-public information], as in the securities context, would leave market participants in the position of choosing among: Disclosing information to counterparties who may not want to know it because of the effect on their trading activity, violating the antifraud rule by performing their obligations under the SBS contract while in possession of [material non-public information] or abstaining from performance and defaulting on the contract.'' *See* July 2011 SIFMA Comment Letter at 3.

[88] *See* re-proposed Rule 9j–1(f)(1). In general, for uncleared security-based swap transactions, the relevant documentation should include the written security-based swap trading relationship documentation executed by the counterparties. For cleared security-based swap transactions, the relevant documentation should include the written agreement between the applicable counterparty and the clearing agency. For SBS Entities, existing 17 CFR 240.15Fi–5 (''Rule 15Fi-5'') requires each SBS Entity to establish, maintain, and follow written policies and procedures reasonably designed to ensure that it executes written trading relationship documentation with each of its counterparties, subject to certain exceptions, prior to, or contemporaneously with, executing a security-based swap transaction, in each case in the manner as provided for in the rule. That documentation is also subject to the Commission's recordkeeping requirements in 17 CFR 240.17a–4 or 17 CFR 240.18a–6, as applicable.

[89] *See* re-proposed Rule 9j–1(f)(2). Rule 15Fi–1(a) defines the term ''bilateral portfolio compression exercise'' to mean ''an exercise by which two security-based swap counterparties wholly terminate or change the notional value of some or all of the security-based swaps submitted by the counterparties for inclusion in the portfolio compression exercise and, depending on the methodology employed, replace the terminated security-based swaps with other security-based swaps whose combined notional value (or some other measure of risk) is less than the combined notional value (or some other measure of risk) of the terminated security-based swaps in the exercise.'' 17 CFR 240.15Fi–1(a). Rule 15Fi–1(j) defines the term ''multilateral portfolio compression exercise'' to mean ''an exercise by which multiple security-based swap counterparties wholly terminate or change the notional value of some or all of the security-based swaps submitted by the counterparties for inclusion in the portfolio compression exercise and, depending on the methodology employed, replace the terminated security-based swaps with other security-based swaps whose combined notional value (or some other measure of risk) is less than the combined notional value (or some other measure of risk) of the terminated security-based swaps in the exercise.'' 17 CFR 240.15Fi–1(j).

[90] *See* Risk Mitigation Techniques for Uncleared Security-Based Swaps, Exchange Act Release No. 87762 (Dec. 18, 2019), 85 FR 6359 at 6391 (Feb. 4, 2020) (''Risk Mitigation Adopting Release'').

manage, maintain, and settle, resulting in fewer opportunities for processing errors, failures, or other problems that could develop throughout the lifecycle of a transaction.[91] Given these important benefits, as well as the largely administrative nature of the portfolio compression process, the Commission believes it to be appropriate to provide a safe harbor for this activity in circumstances where the security-based swap counterparty is in possession of material non-public information with respect to a reference entity underlying an applicable security-based swap.

However, the proposed safe harbor would apply only so long as: (1) 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 the methodology used in the exercise, and (2) 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. This condition, which the Commission believes is consistent with how portfolio compression exercises typically operate, is intended to help ensure that most, if not all, of the opportunities to take a discretionary action to impact the outcome of the compression exercise occur before the process begins, and therefore before specific security-based swap transactions are identified to be added or eliminated. Finally, this safe harbor, which is limited to circumstances involving the misuse of material non-public information, would not apply where the portfolio compression exercise itself was part of a fraudulent or manipulative scheme to increase (in the case of the receiving counterparty) or decrease (in the case of the delivering counterparty) the amount of any payment made or received in connection with a terminated or replacement security-based swap transaction resulting from the portfolio compression exercise, as applicable.

3. Prohibition on Price Manipulation

In addition to the general antifraud and anti-manipulation provisions discussed above, re-proposed Rule 9j–1 also contains provisions designed to address price manipulation similar to CFTC Rule 180.2.[92] Specifically, re-proposed Rule 9j–1 includes a prohibition on attempted manipulation. Re-proposed Rule 9j–1(b) would make 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. Among other things, this language is intended to address a number of the manufactured or other opportunistic CDS strategies observed over the last decade, and summarized above in section I.B, including situations where a party intentionally distorts any payment related to a security-based swap for the benefit of one of the security-based swap counterparties, such as actions that serve little to no economic purpose other than to artificially influence the composition of the deliverable obligations in a CDS auction.[93]

Re-proposed Rule 9j–1(b) also is intended to prohibit, among other things, a situation where a person (or group of persons) improperly and intentionally causes or avoids the purchase or sale of a security-based swap for the benefit of a counterparty to an SBS, such as intentionally and improperly orphaning a CDS, avoiding termination of a CDS for a period of time, or causing the termination of a CDS. As previously noted, ''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.[94] 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.[95] To be clear, 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 re-proposed Rule 9j–1(b).

Moreover, the Commission does not intend for re-proposed Rule 9j–1(b) to apply to taking affirmative actions in the ordinary course of a security-based swap transaction or the underlying referenced security. Specifically, re-proposed Rule 9j–1(b) is designed to capture situations when a payment under the security-based swap is *intentionally distorted.* A determination as to whether a payment is intentionally distorted will largely depend on the facts and circumstances of each particular situation, but as a general matter the Commission would expect to use its authority to bring an enforcement action under re-proposed Rule 9j–1(b) when a party takes 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.

The Commission recognizes that reference entities often rely on financing and other forms of relief to avoid defaulting on their debt, and the proposed 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 proposing Rule 9j–1(b) to account for actions taken outside the ordinary course of a typical lender-borrower relationship (or a prospective lender-borrower relationship). Although any such determination would need to be based on the facts and circumstances of a particular situation, as a general matter the Commission believes that an action that appears to be designed almost exclusively to harm one or more CDS counterparties would likely fall within the prohibition in re-proposed Rule 9j–1(b).

C. Liability Under Proposed Rule 9j–1 in Connection With the Purchase or Sale of a Security

Finally, and consistent with the long-standing principle that parties cannot do indirectly what they are prohibited from doing directly, paragraphs (c) and (d) of re-proposed Rule 9j–1 would make it clear that market participants cannot 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 provide that a person could not escape liability for trading based on possession of material non-public information about a security by purchasing or selling a security-based swap based on that security (as opposed to trading in the security itself) and the second provision provides that a person could not escape liability under Section 9(j) or re-proposed 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).

[91] *See id.*

[92] *See* 17 CFR 180.2.

[93] *See* Fletcher, *supra* note 21 at 1096–98.

[94] *See supra* note 27 and accompanying text.

[95] *See* Fletcher, *supra* note 21 at 1101.

Specifically, re-proposed Rule 9j–1(c) would provide that wherever communicating, or purchasing or selling a security (other than a security-based swap) while in possession of, material non-public 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. Rule 9j–1(c) would be modeled after Section 20(d) of the Exchange Act, which is substantially similar to the proposal, except that the statutory provision applies to ''a put, call, straddle, option, privilege or security-based swap agreement''—*i.e.,* it does not expressly include the term security-based swap.[96]

Although the Commission generally believes that a situation where a person uses material non-public information in a security in connection with the purchase and 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, the Commission also believes that market participants would benefit from a clarified interpretation of that statutory provision in this rulemaking.[97] 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 proposing new Rule 9j–1(c) to provide that a person making a purchase or sale of a security-based swap while in possession of material non-public information with respect to the security underlying such security-based swap is subject to liability.

Lastly, the Commission also is proposing new Rule 9j–1(d), which is intended to address a situation similar to the one described above, but in the other direction. Specifically, re-proposed Rule 9j–1(d) would provide that whenever purchasing or selling a security-based swap would violate, or result in liability under Section 9(j) of the Exchange Act or re-proposed Rule 9j–1(a) or (b), 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 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 re-proposed Rule 9j–1(a) or (b).

This provision is designed so that a person cannot escape liability under Section 9(j) or re-proposed Rule 9j–1(a) or (b) with respect to a security-based swap by limiting all of its actions to purchases and sales of the security 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 swap position, such person would be liable for violations of Section 9(j) and re-proposed Rule 9j–1 regardless of the fact the manipulation was conducted through purchases and sales of the equity securities.

To be clear, re-proposed Rule 9j–1(d) is not intended to create a separate category of prohibited activity. Rather, this provision is designed to specify that many of the activities that would be considered fraud, manipulation, or deceit with respect to a security-based swap are typically effected through transactions in the underlying reference entity, security, loan, or group or index of securities or loans. The Commission believes that this provision is important to include in the rule because security-based swaps by their nature are tied intrinsically to activity in other securities markets.

Moreover, this provision is not intended to suggest that a person could be liable for violations of Section 9(j) and re-proposed Rule 9j–1 based solely on the impact of its transactions on the equity, debt, or loan markets. In that regard, the rule would state 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 loans, or be an affiliate of, or a person acting in concert with, such security-based swap counterparty in furtherance of such prohibited activity. Finally, and in addition to analyzing whether transactions in the underlying equity or debt securities or loans have been used as the mechanism for violations of Section 9(j) and re-proposed Rule 9j–1, the Commission also would expect to analyze the same activities to determine whether they independently would also constitute violations under the existing 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, as it relates the market for those underlying equity or debt securities or loans.

D. Preventing Undue Influence Over Chief Compliance Officers; Policies and Procedures Regarding Compliance With Re-Proposed Rule 9j–1, Proposed Rule 10B–1 and Proposed Rule 15Fh–4(c)

In addition to proposing rules to prevent fraudulent, manipulative, or deceptive conduct in connection with security-based swaps, the Commission also is proposing 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, new Rule 15Fh–4(c) would make 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.

The Commission previously considered whether to adopt a similar requirement when it adopted business conduct standards for SBS Entities in 2016.[98] That rulemaking included, among other things, 17 CFR 240.15Fk–1 (''Rule 15Fk–1''), which requires an

[96] *See* 15 U.S.C. 78t(d). Re-proposed Rule 9j–1(c) also differs from Section 20(d) in two other ways. First, the statutory provision refers to insider trading violations under the entirety of Title 15 of the U.S.C., the proposed rule refers only to the Exchange Act and the Securities Act, which are the two most common bases for asserting the Commission's authority for insider trading violations. Second, re-proposed Rule 9j–1(c) makes clear that the reference to a ''security'' does not include a security-based swap. This is intended solely to avoid confusion given that a security-based swap is included in the definition of ''security'' in Section 3(a)(10) of the Exchange Act [15 U.S.C. 78c(a)(10)] and Section 2(a)(1) of the Securities Act [15 U.S.C. 77b(a)(1)].

[97] Pursuant to Section 20(d), a person with material non-public information about a security cannot avoid liability under the securities laws by making purchases and 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 non-public information by making purchases and sales of a security-based swap (*e.g.,* a swap on the security itself).

[98] *See* Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Release No. 77617 (Apr. 14, 2016), 81 FR 29960 (''Business Conduct Standards Adopting Release'').

SBS Entity to designate a CCO and imposes certain duties and responsibilities on that CCO,[99] and Rule 15Fh–4(a), which makes it unlawful for an SBS Entity to: (i) Employ any device, scheme, or artifice to defraud any special entity or prospective customer who is a special entity; (ii) 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 (iii) engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative.[100] In the course of that rulemaking, one commenter requested that the Commission adopt a rule prohibiting attempts by officers, directors, or employees to coerce, mislead, or otherwise interfere with the CCO.[101] The Commission considered that request, but ultimately concluded not to adopt such a rule, explaining that ''requiring a majority of the board to approve the compensation and removal of the CCO is appropriate to promote the CCO's independence and effectiveness. . . .'' [102]

Moreover, at the time the Commission declined to include a rule regarding undue influence over the CCO, the Commission had not yet finalized most of the requirements for which the CCO of an SBS Entity would be responsible and had not yet proposed rules relating to trading relationship documentation, dispute resolution, portfolio reconciliation or portfolio compression (''Risk Mitigation Rules'').[103] 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.[104] 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.

In light of the re-proposal of Rule 9j–1 and the proposal of 10B–1 as well as the rules finalized subsequent to the CCO rules, the Commission believes it is appropriate to reconsider the need for a rule expressly prohibiting interference with the performance of a CCO's duties, even if not directly related to compensation or the threat of removal of the CCO to help ensure the independence and effectiveness of the CCO function.[105] In connection with re-proposed Rule 9j–1 and proposed Rule 10B–1, as well as 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. 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 would require public reporting and thwart the plans of the employee.

Although re-proposed Rule 9j–1 and proposed Rule 10B–1 apply to any person, without exception, and not just SBS Entities, as discussed in the Economic Analysis, the security-based swap market is dominated by dealers. The Commission estimates that dealing activity in security-based swap markets is highly concentrated among a small number of firms who are or will be registered with the Commission as SBS Entities.[106] Because of the concentration of security-based swap activities in a small number of firms that are SBS Entities, their compliance with the Federal securities laws, including those adopted since 2016 and any rules adopted as a result of this proposal, is critically important to fostering integrity in the security-based swap market.

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.[107] In addition, existing Rule 15Fk–1 requires an SBS Entity to designate a CCO, who must comply with certain duties, including to ''[t]ake 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].'' [108] 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 re-proposed Rule 9j–1, and proposed rules 10B–1 and 15Fh–4(c) if adopted), may result in violations by the SBS Entity of Rule 15Fh–3(h), as well as Rule 15Fk–1.[109] Proposed Rule 15Fh–4(c) is designed to protect investors and promote the fairness of the markets by supporting the ability of the CCO to meet the CCO's important obligations to foster compliance without undue influence, which should ultimately support the integrity of SBS Entities and the markets.

E. Request for Comment

The Commission generally requests comments on all aspects of re-proposed Rule 9j–1. In addition, the Commission requests comments on the following specific issues:

[99] *See* 17 CFR 240.15Fk–1.

[100] *See* 17 CFR 240.15Fh–4(a).

[101] *See* Business Conduct Standards Adopting Release, 81 FR at 30053, n. 1166 and accompanying text.

[102] *See id.* at 30054–55.

[103] *See supra* note 2. The Commission first proposed the Risk Mitigation Rules in December 2018. *See* Risk Mitigation Techniques for Uncleared Security-Security-Based Swaps, Exchange Act Release No. 87782 (Dec. 19, 2018), 84 FR 4614 (Feb. 15, 2019).

[104] *See* Risk Mitigation Adopting Release, 85 FR at 6390.

[105] 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 antifraud or other provisions of the securities laws or aiding or abetting or causing an issuer's violations of the securities laws.'' *See* 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, proposed 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 at 74721–22 (Dec. 24, 2003).

[106] *See infra* section VI.C.2. *See also* Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutory Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps, Exchange Act Release No. 84858 (Dec. 19, 2018), 84 FR 4906, 4923 (Feb. 19, 2019) (''[t]he Commission estimates that dealing activity in security-based swap markets is highly concentrated among a small number of dealers, with the top five dealer accounts intermediating approximately 55 percent of all SBS Entity transactions, and reaching hundreds and even thousands of counterparties.'') (internal citations omitted).

[107] *See* 17 CFR 240.15Fh–3(h).

[108] *See* 17 CFR 240.15k–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) (''Rule 15Fb2–1(b)'').

[109] The SBS Entity could also face liability under Rules 15Fb2–1(b) and (h) under such circumstances.

• Do commenters agree or disagree with any particular aspects of re-proposed Rule 9j–1? If so, which ones and why? If commenters disagree with any provision of the re-proposed rule, how should such provision be modified and why?

• As noted in section I.A, the existing 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, already apply to security-based swaps because they fall within the definition of ''security'' in each of those statutes. Are there particular aspects of security-based swap transactions and the security-based swap markets that the Commission should specifically address? If so, does re-proposed Rule 9j–1 address those areas? If not, what types of fraudulent or manipulative activity, if any, might not be captured by the existing antifraud or anti-manipulation provisions or re-proposed Rule 9j–1, and how might new rules be drafted to address such activity?

• Do commenters agree with the inclusion and scope of the proposed safe harbors in re-proposed Rule 9j–1(f)? Why or why not? Should the actions permitted under the proposed safe harbor be limited solely to circumstances involving actions taken when a person is aware of material nonpublic information? Why or why not? Should the Commission include additional safe harbors in re-proposed Rule 9j–1 to address other types of ordinary course business activities, both in relation to a security-based swap transaction or any reference obligation? If so, how should the Commission define such activities?

• As discussed above, in response to operational concerns raised by commenters on the 2010 proposed rule, the Commission is proposing two limited safe harbors from re-proposed Rule 9j–1(a) to address situations when a counterparty to a security-based swap is required to take certain actions while in possession of material non-public information. Should the Commission also create a safe harbor for entering into security-based swap transactions for purposes of hedging some or all of their exposure arising out of lending activities with a reference entity or the syndication of such lending activities? Why or why not? If such a safe harbor is necessary, should ''hedging'' be defined and if so, how should it be defined? What types of activities should be included and/or excluded in such a safe harbor? What conditions should be included to protect other market participants and to ensure that any such safe harbor is not overly broad? For example, should the safe harbor require that a person using a security-based swap to hedge their interest in a loan while in possession of material nonpublic information provide certain information to their counterparty about the underlying borrower/reference entity? If so, what information should be required to be provided, and why? Should the safe harbor be conditioned on the person using a security-based swap to hedge their interest in a loan being a particular type of financial institution, such as a bank? Why or why not? Should the safe harbor be time limited, for example by requiring that the security-based swap be executed contemporaneously with the execution of the loan or the syndication of the loan? If so, how should such condition be structured? Could a safe harbor for hedging be constructed in a way to always distinguish legitimate hedging activity from other types of transactions? If so, how?

• As previously noted, re-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, require scienter. In contrast, re-proposed Rules 9j–1(a)(3) and (4) would not require scienter, consistent with Sections 17(a)(2) and (a)(3) of the Securities Act. Do commenters agree with the proposed standards of care in re-proposed Rule 9j–1(a)? Why or why not? If not, what should be the standard of care for each aspect of re-proposed Rule 9j–1(a) and why? Also, should the standard of care be different from the existing provision on which it was based, and if so, how and why? For example, if re-proposed Rules 9j–1(a)(1) and (2) continue to be based on Section 10(b) of the Exchange Act and Rule 10b–5 thereunder, and Section 17(a)(1) of the Securities Act, which require scienter, why should the proposed provisions rely on a different standard of care?

• One difference between re-proposed Rule 9j–1(a) and the 2010 proposed rule is that the four provisions based on Section 10(b) of the Exchange Act and Rule 10b–5 thereunder, and Section 17(a) of the Securities Act now refer to both actual conduct and *attempted* conduct. Do commenters agree with the change, as compared to the 2010 proposed rule, to extend those provisions in this manner? Why or why not?

• Do commenters agree with the application of re-proposed Rule 9j–1(a) to actions to exercise or any action related to performance pursuant to any security-based swap including 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 addition to, among other things, purchases or sales of, or actions to effect transactions in, security based swaps)? Why or why not?

• Re-proposed Rule 9j–1(a) differs from the 2010 proposed rule in that the current proposal is structured such that that the exercise of authority under the rule applies to certain specified actions being taken ''in connection'' with the fraudulent or manipulative conduct specified in paragraphs (1) through (4) of the re-proposed rule. By contrast, the 2010 proposed rule required that the fraudulent or manipulative conduct be ''in connection'' with the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance. The Commission is proposing the change to more closely track the language of Section 9(j) of the Exchange Act. Do commenters believe that this change better delineates the actions that would be subject to the rule or does it create confusion?

• Do commenters agree with the inclusion of re-proposed Rule 9j–1(b), which makes 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? Why or why not? Should the Commission modify the proposed rule to expressly apply to the types of manufactured or other opportunistic behavior that have been occurring in the credit derivatives market and that are discussed in section II.B.3? If so, which ones and why? Are there additional types of manufactured or other opportunistic behavior that have been observed in the credit derivatives market that may be considered transactions, acts, practices, and courses of business that are fraudulent, deceptive, or manipulative, or involve such quotations as are fictitious? If so, which activities should be expressly prohibited and why?

• Re-proposed Rule 9j–1(c) would generally provide that a person could not avoid liability for insider trading by purchasing or selling a security-based swap while in possession of material non-public information with respect to a security or group or index of securities underlying such security-based swap if the person would otherwise have been liable had they purchased or sold the relevant securities. Do commenters agree with the inclusion of this provision? Why or why not? If not, how

should this provision be modified and why?

• Re-proposed Rule 9j–1(d) would generally provide that a person could not avoid liability under Section 9(j) of the Exchange Act or re-proposed Rule 9j–1 by purchasing or selling one or more securities underlying a security-based swap, as opposed to purchasing or selling the security-based swap itself if the person would otherwise have been liable under Section 9(j) of the Exchange Act or re-proposed Rule 9j–1 had they purchased or sold the security-based swap. Do commenters agree with the inclusion of this provision? Why or why not? If not, how should this provision be modified and why?

• Should the Commission adopt proposed Rule 15Fh–4(c), which would make it 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? Why or why not?

• Should proposed Rule 15Fh–4(c) only apply to officers or directors? Why or why not?

• Should proposed Rule 15Fh–4(c) apply to any person? Why or why not?

• Should proposed Rule 15Fh–4(c) be limited to actions to coerce, manipulate, or fraudulently influence the CCO? Should the proposed rule be limited to actions to mislead? Should the types of actions explicitly prohibited be expanded? If so, how and why?

• Should the Commission consider other means to protect the CCO in the performance of their duties?

• Should the Commission consider expanding proposed Rule 15Fh–4(c) to protect other officers of an SBS Entity in the performance of their duties? If so, which officers and why?

III. Proposed Rule 10B–1: Position Reporting of Large Security-Based Swap Positions

As previously noted, Section 10B of the Exchange Act, which provides the Commission with authority to establish position limits for security-based swaps, also provides the Commission with rulemaking authority to require reporting of large security-based swap positions. Specifically, Section 10B(d) authorizes the Commission to:

". . . require any person that effects transactions for such person's own account or the account of others in any securities-based swap or uncleared security-based swap and any security or loan or group or narrow-based security index of securities or loans . . . to report such information as the Commission may prescribe regarding any position or positions in any security-based swap or uncleared security-based swap and any security or loan or group or narrow-based security index of securities or loans and any other instrument relating to such security or loan or group or narrow-based security index of securities or loans . . ." [110]

The Commission has not previously proposed rules using its authority under Section 10B with respect to either position limits or reporting of large positions in security-based swaps. However, the Commission's observations of the security-based swap market suggest a number of potential benefits of requiring reporting. Those benefits, which are described in greater detail above in section I.C. include: (1) Providing market participants (including counterparties, issuers and issuers' stakeholders) and regulators with access to information that may indicate that a person (or a group of persons) is building up a large security-based swap position, which in some cases could be indicative of potentially fraudulent or manipulative purposes; (2) alerting market participants and regulators to the existence of concentrated exposures to a limited number of counterparties, which should inform those market participants and regulators of the attendant risks, allow counterparties to risk manage and lead to better pricing of the security-based swaps with respect to transactions with persons holding large positions in those security-based swaps; and (3) in the case of manufactured or other opportunistic strategies in the CDS market, providing market participants and regulators with advance notice that a person (or a group of persons) is building up a large CDS position which could create an incentive to vote against their interests as a debt holder, possibly with an intent to harm the company, even if such conduct is not inherently fraudulent.

Moreover, given that a number of these benefits accrue not only to the Commission, as the primary regulator of the security-based swap market (and potentially other regulators), but also to market participants (including reference entities), the Commission also believes that such reports should be made publicly available.[111] At the same time, however, the Commission understands that certain aspects of a security-based swap transaction may be sensitive or proprietary, particularly as they relate to a market participant's relationship with its counterparties, and accordingly we are not proposing to require reporting persons to publicly disclose any information about their counterparties, including their identities. Rather, under the proposed rule persons subject to the reporting requirement would only need to report the amount of their aggregated positions in a security-based swap on a single reference underlier, as well as any underlying or related positions.[112] However, to the extent that Commission staff believes it important to obtain counterparty information as part of our regulatory mission as it relates to one or more particular filings, staff would endeavor to obtain such information either directly from the filer (if so registered with the Commission) or from a registered SBSDR pursuant to Regulation SBSR.

Accordingly, the Commission is proposing to use its rulemaking

[110] *See* 15 U.S.C. 78j–2.

[111] *See supra* section I.C. Several academics discuss disclosure as a potential solution to some of the manufactured or other opportunistic CDS strategies described in section I.C. *See* Fletcher, *supra* note 21 at 1139–40 ("By requiring disclosure of plans to engage in an engineered CDS transaction, traders are able to reject counterparties that have indicated their intentions to intervene in the market. Alternatively, it allows CDS traders to decide if they want to charge or demand a higher price from the counterparty to offset the risk of loss. Disclosure, therefore, minimizes informational asymmetry between the counterparties, which would increase the cost of engineered transactions and in turn lower their profitability and their occurrence. Additionally, this disclosure requirement may also enhance market discipline, enabling CDS traders to avoid counterparties that might engage in engineered transactions or have done so in the past."). Other academics have made similar points in the broader context, some as far back as 2008. *See* Henry T.C. Hu and Bernard S. Black, Debt, Equity, and Hybrid Decoupling: Governance and Systemic Risk Implications, U of Texas Law, Law and Econ Research Paper No. 120, 31 (June 1, 2008) (". . . to address debt . . . decoupling, we propose . . . disclosure of their aggregate holdings of debt and debt derivatives"); *see also* Patrick Bolton and Martin Oehmke, Credit Default Swaps and the Empty Creditor Problem 24:8 Rev. Fin. Stud., 7 (Jan. 4, 2011) (". . . disclosure of CDS positions may mitigate the inefficiencies resulting from the empty creditor problem, without undermining the ex ante commitment effect of CDS. In particular, if public disclosure allows borrowers and lenders to contract on CDS positions, they may allow the lender to commit not to over-insure once he has acquired the bond. More generally, public disclosure of positions may also be beneficial by giving investors a more complete picture of creditors' incentives in restructuring."); *see also* Danis and Gamba, *supra* note 21 at 33 ("The CDS market is very opaque, and no regular investor knows how many protection sellers there are, how much protection they have sold, and whether they have deep pockets to inject cash into the underlying firm. Therefore, we argue that it is possible that regulation that improves the transparency of the CDS market can increase firm value. Other authors have proposed disclosure requirements in the CDS market as well . . . , although for different reasons.")

[112] *See infra* section III.B.

authority under Section 10B of the Exchange Act to propose a large trader position reporting rule for security-based swaps. That proposal is described in detail below.

A. Proposed Definitions and Thresholds

Proposed Rule 10B–1(a)(1) would require any person (and any entity controlling, controlled by or under common control with such person), or group of persons, who through any contract, arrangement, understanding or relationship, after acquiring or selling directly or indirectly, any security-based swap, is directly or indirectly the owner or seller of a Security-Based Swap Position that exceeds the Reporting Threshold Amount, to promptly file with the Commission a statement containing the information required by 17 CFR 240.10B–101 (''Schedule 10B'') on the Commission's Electronic Data Gathering, Analysis, and Retrieval system (''EDGAR'').[113] These reports would be made publicly available immediately upon filing.

Additionally, a person owns a Security-Based Swap Position by virtue of participation in a group of persons pursuant to any contract, arrangement, understanding or relationship, the proposed rule would provide that the group's filing obligation may be satisfied either by a single joint filing or by each of the group members making an individual filing.[114] If the group's members elect to make their own filings, each filing would be required to identify all members of the group, but the information provided concerning the other persons making the filing would need only to reflect information which the filing person knows or has reason to know.[115]

Moreover, the proposed rule also contains a provision intended to prevent evasion of the reporting requirement. Specifically, proposed Rule 10B–1(b)(4) provides that any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device as part of a plan or scheme to evade the reporting requirements of paragraph (a)(1) of this section with respect to a Security-Based Swap Position shall be deemed for purposes of this section to be the owner of such Security-Based Swap Position.[116] For example, if a number of entities agreed to acquire separate Security-Based Swap Positions that each fell below the relevant threshold in order to evade the requirement to report the larger, aggregated Security-Based Swap Position that exceeded the relevant threshold), proposed Rule 10B–1(a)(4) would deem each entity that was party to the arrangement to be the owner of the aggregated Security-Based Swap Position.

With respect to the scope of persons subject to this proposal, Section 10B provides the Commission with authority to require reporting by ''any person that effects transactions for such person's own account or the account of others [in security-based swaps and related financial instruments].'' [117] The Commission considered whether to limit this reporting requirement to certain types of persons, such as SBS Entities. However, and as described above, proposed Rule 10B–1 is ultimately intended to provide both the Commission and the market with information about any large positions in security-based swaps and any related securities that, in the event of a default, could have an impact on the markets, counterparties, or other market participants. This includes those positions that could adversely impact issuers of reference entities and their stakeholders, and those that could influence counterparties' risk management decisions or pricing of security-based swaps. Accordingly, the requirements in proposed Rule 10B–1 apply to ''any person,'' regardless of whether they are registered with the Commission in any capacity.

In terms of timing, proposed Rule 10B–1(a)(2) would provide that any Schedule 10B required by the rule shall be filed promptly, but in no event later than the end of the first business day following the day of execution of the security-based swap transaction that results in the Security-Based Swap Position first exceeding the Reporting Threshold Amount. That timing is consistent with the requirement in existing 17 CFR 240.15Fi–2(b) (''Rule 15Fi–2(b)''), which governs the timeframe for when an SBS Entity is required to provide a trade acknowledgment to its counterparty after executing a security-based swap transaction.[118] The Commission believes using a similar approach in proposed Rule 10B–1 is appropriate given that once a security-based swap transaction reaches the point when an SBS Entity is required to deliver a trade acknowledgment of a security-based swap to its counterparty, both sides to the transaction should then have the information about the size of the transaction so that each can determine whether any applicable Security-Based Swap Position has exceeded the Reporting Threshold Amount.[119]

Proposed Rule 10B–1 also contains key definitions for determining the scope of the position to be disclosed. In particular, the term ''Security-Based Swap Position'' would be defined to mean all security-based swaps based on: (a) A single security or loan, or a narrow-based security index, or any interest therein or based on the value thereof; (b) any securities issued by the

[113] *See* proposed Rule 10B–1(a). Because these position reports on proposed Schedule 10B would be made publicly available, the Commission is proposing to require them to be filed on EDGAR, similar to the way that beneficial ownership reports are filed pursuant to Sections 13(d) and (g) of the Exchange Act. *See* Rule 101(a)(1)(iii) of Regulation S–T (17 CFR 232.101(a)(1)(iii)) (requiring all statements, reports, and schedules filed with the Commission pursuant to Section 13 of the Exchange Act, among other provisions, to be submitted to the Commission in electronic form). If commenters believe that an alternate means of submission would be more appropriate, the Commission welcomes such feedback and encourages commenters to be as detailed as possible when specifying how such an alternative process would work, either in addition to or in lieu of the requirement to file proposed Schedule 10B on EDGAR.

[114] *See* proposed Rule 10B–1(a)(3).

[115] *See id.* The requirements related to the process for satisfying a group's filing obligations are similar to how the issue is addressed in 17 CFR 240.13d–1 (''Rule 13d–1''), which relates to the filing of Schedules 13D and 13G. Specifically, Rule 13d–1(k)(2) provides that ''[a] group's filing obligation may be satisfied either by a single joint filing or by each of the group's members making an individual filing. If the group's members elect to make their own filings, each such filing should identify all members of the group but the information provided concerning the other persons making the filing need only reflect information which the filing person knows or has reason to know.'' 17 CFR 240.13d–1(k)(2).

[116] *See* proposed Rule 10B–1(a)(4).

[117] *See* 15 U.S.C. 78j–2.

[118] *See* 17 CFR 240.15Fi–2(b).

[119] Rule 15Fi–2 also contains a second step once the applicable SBS Entity provides its counterparty with the required trade acknowledgment. Specifically, the rule also requires that the SBS Entity: (i) Establish, maintain, and enforce written policies and procedures that are reasonably designed to obtain prompt verification of the terms of a trade acknowledgment; and (ii) promptly verify the accuracy of, or dispute with its counterparty, the terms of a trade acknowledgment that it receives. *See* 17 CFR 240.15Fi–2(d). The Commission has determined to base the timing requirement in proposed Rule 10B–1 on the requirement to *deliver* a trade acknowledgment of a security-based swap, as opposed to the requirement to *verify* the trade acknowledgment due to the fact the rule does not require a counterparty that is not an SBS Entity to verify the trade acknowledgment. Rather, the regulatory obligation runs only to the SBS Entity, which is required to establish, maintain, and enforce written policies and procedures that are reasonably designed to obtain prompt verification of the terms of a trade acknowledgment. Moreover, while the Commission recognizes that the amount of the security-based swap transaction is clearly a term that would need to be resolved during the trade verification process if there is a dispute as to such value, the Commission believes that in most cases any such dispute would be resolved on a near real-time basis given the importance of that term as it relates to all of the other terms of the transaction.

same issuer (each, an ''issuing entity'') of the securities, loans, or securities included in the narrow-based index (including any interest therein or based on the value thereof) described in (a); or (c) any narrow-based security index that includes any of those issuing entities or their securities (including any interest therein or based on the value thereof), in each case as applicable.[120] To the extent that a Security-Based Swap Position is based on a single security or loan that is included in a narrow-based security index, the calculation of the Security-Based Swap Position with respect to a particular component of the index would be based on the weighting of the reference entity or securities as a component of the index. With respect to security-based swaps based on equity securities, a Security-Based Swap Position shall include all security-based swaps based on a single class of equity securities.[121]

Under this definition, a security-based swap that is based on a narrow-based security-index could trigger a reporting obligation under proposed Rule 10B–1 in two different ways. First, reporting under proposed Rule 10B–1 would be required if a person had a Security-Based Swap Position composed of security-based swaps based on a narrow-based security index that itself exceeded the relevant Reporting Threshold Amount. Second, if a person had a Security-Based Swap Position composed of security-based swaps based on a single security or loan, that person would need to include in the calculation of that position all security-based swaps based on the applicable single security or loan, in an amount proportionate to the weighting of the security or loan in the narrow-based security index. As a hypothetical example, if a person is a counterparty to a security-based swap on a narrow-based security index composed of equity securities with a notional amount of $100 million, the Security-Based Swap Position on the index itself would also be $100 million. In addition, if one security makes up 40% of that index by weight, that person would also be considered to have a Security-Based Swap Position of $40,000,000 attributable to such security for purposes of that transaction (which would need to be added to any other security-based swaps based on the same security in calculating the entire Security-Based Swap Position with respect such security).[122]

The Commission believes that the reporting requirement in proposed Rule 10B–1 should represent a person's *gross* position in a security-based swap [123] due to the fact that the proposed rule is intended to, among other things, identify circumstances when a market participant has a large, concentrated position in a security-based swap on a single issuer, which has the potential to impact not only the market for other security-based swaps on the same issuer, but also the applicable reference securities, even if that gross position consists of smaller positions that offset each other.[124] In such an instance, the gross position would be particularly informative where the offsetting positions are not with the same counterparty, where it may not be possible to net out any payment obligations between any two counterparties. For example, if a reporting person was long a total return swap with one counterparty and short a total return swap with a second counterparty (on the same reference equity security), a large decline in the price of the underlying security could trigger large payment obligations under both transactions, which could require one or more persons to liquidate some or all of the securities held to hedge the applicable total return swap. Under those circumstances, reporting the gross position would alert each of the two counterparties to the reporting person's overall exposure, which may be relevant to the extent that the counterparty to the other transaction is unable to satisfy its payment or delivery obligations.

The Commission also believes that requiring reporting of a person's aggregate Security-Based Swap Position (*i.e.,* all security-based swaps on the same reference entity, security, loan, or group or index of securities or loans that a person has with all their counterparties) is important for identifying positions that may have a significant impact on the person's counterparties, companies whose securities are referenced by a security-based swap, and the market as a whole, as discussed above in section I.C. For example, if a person has a large Security-Based Swap Position that is broken up between a number of different counterparties, reporting of the aggregated position could alert each individual counterparty to the fact that the reporting person also has significant exposure to other individual counterparties with respect to the same security-based swap.

For purposes of the definition of ''Security-Based Swap Position,'' security-based swaps based on a single class of equity securities issued by a reference entity would constitute a separate Security-Based Swap Position than security-based swaps based on debt securities of the same reference entity. A Security-Based Swap Position based on CDS also would constitute a separate Security-Based Swap Position.[125] As a result, there is a separate definition of ''Reporting Threshold Amount'' (as discussed in detail below) for Security-Based Swap Positions in each of: (i) CDS, (ii) debt security-based swaps (excluding CDS), and (iii) equity security-based swaps. For example, under that definition, a Security-Based Swap Position would include all security-based swaps on equity securities issued by XYZ Corporation, regardless of the fact that the position may be split among a number of counterparties. If the same reporting person also had CDS positions based on debt securities issued by XYZ Corporation, those CDS positions would constitute a separate Security-Based Swap Position. Lastly, if the same reporting person was also party to security-based swaps based on debt securities issued by XYZ Corporation that were not CDS, those transactions would constitute yet another separate Security-Based Swap Position.

However, proposed Schedule 10B would require the reporting party to report other securities (including other security-based swaps) that are related to the applicable Security-Based Swap Position.[126] Thus, if a reporting party has a Security-Based Swap Position composed of non-CDS security-based swaps on *debt* securities of XYZ Corporation that exceeds the relevant

[120] *See* proposed Rule 10B–1(b)(3).

[121] *See id.*

[122] As discussed below, for equity-based Security-Based Swap Positions the proposed rule would include both a notional threshold and a threshold based on the number of shares attributable to the Security-Based Swap Position. As a result, a person would need to convert the proportionate notional amount of a component security of a narrow-based security-index into a share count. In the above example, the notional amount of $40,000,000 would need to be converted into a share count using the methodologies set forth in proposed Rule 10B–1(b)(4). *See infra* section III.A.2.

[123] For purposes of this release, the term ''gross'' means the sum of the absolute values of notional amounts outstanding of all of the security-based swaps included in a Security-Based Swap Position. For example, if a person has a $75 million long CDS position and a $75 million short CDS position on the same reference entity or security, the person will have a Security-Based Swap Position of $150 million.

[124] As a hypothetical, if a person has a large, hedged position in an equity swap and is required to quickly liquidate its hedged positions in the reference securities in order to close out the security-based swap position, the transactions made to liquidate the reference securities could potentially impact the price of those securities depending on the size of the hedged position.

[125] *See id.*

[126] Section III.B. below discussed the information required to be included in proposed Schedule 10B.

threshold, as well as a Security-Based Swap Position composed of security-based swaps on *equity* securities of XYZ Corporation that does *not* exceed the threshold for reporting, such person would be required to report the debt-based Security-Based Swap Position on proposed Schedule 10B on which the person would need to report the equity-based security-based swaps as related securities.[127] If *both* the debt-based Security-Based Swap Position and the equity-based Security-Based Swap Position exceeded the applicable threshold, the reporting party would need to file a separate Schedule 10B for each position, which could cross-reference to the other filing for purposes of disclosing related securities.

1. Reporting Thresholds for Debt Security-Based Swaps (Including CDS)

Proposed Rule 10B–1(b)(1) sets forth the definition of ''Reporting Threshold Amount.'' That definition is bifurcated depending on whether the security-based swap is based on equity or debt, with a further delineation for CDS. For CDS (including CDS where the underlying reference is a group or index of entities or obligations of entities that is a narrow-based security index), the threshold is the lesser of: (i) A long notional amount of $150 million, calculated by subtracting the notional amount of any long positions in a deliverable debt security underlying a security-based swap included in the Security-Based Swap Position from the long notional amount of the Security-Based Swap Position; (ii) a short notional amount of $150 million; or (iii) a gross notional amount of $300 million.[128]

With respect to the $150 million long notional threshold for CDS positions, the Commission believes that a threshold that identifies parties with a significant naked CDS long exposure (or a CDS exposure that significantly exceeds its position in deliverable bonds) could help to more accurately identify situations where a CDS counterparty may be incentivized to act against their own interest as a debt holder (*i.e.,* because they stand more to gain from their CDS than they would lose on their bonds) which, as described above, is a possible indicator of an incentive to create a manufactured or other opportunistic credit event.[129] Put another way, if a bondholder uses long CDS positions solely to hedge their underlying bonds, payments received in connection with the CDS (upon a trigger) generally would be offset by losses on the bonds, leaving the person flat, and therefore not required to report under proposed Rule 10B–1. The Commission believes that $150 million, which again was based on staff's review of the available DTCC–TIW data,[130] appropriately captures naked CDS positions that carry the potential to be used in connection with a manufactured or other opportunistic credit event, even if such an activity would be unlikely to result in a broader impact on the CDS and bond markets.

The Commission also is proposing to use a $150 million notional threshold for short CDS positions. In particular, we believe that this threshold should capture situations where a CDS seller has a large enough position to potentially utilize an opportunistic strategy to avoid or delay a credit event, such as by ensuring a credit event occurs after the expiration of the CDS, or taking actions to limit the number and/or kind of deliverable obligations in order to impact the recovery rate following a credit event.[131] However, because the same dynamic described in the previous paragraph—vis-à-vis the potential motivations of a person with a significant naked CDS long exposure to vote against their own interests as a bondholder—may not exist in the case of a CDS seller, the $150 million notional threshold for short CDS positions does not include a provision allowing the reporting person to net out any deliverable bonds from the calculation.

Accordingly, the Commission is proposing a third threshold to capture the positions of market participants with significant gross CDS positions, notwithstanding the direction of the person's CDS positions or their positions in deliverable bonds. Specifically, the Commission believes that a gross CDS position that equals or exceeds $300 million would likely create enough counterparty concentration risk to potentially have other impacts on the market, even in the absence of a manufactured or other opportunistic credit event. As an example, if a person held $125 million in bonds on ABC Corporation and purchased $200 million in CDS on those bonds (or any other obligations that could be deliverable into an auction after a Credit Event), those two positions would offset each other, such that the net Security-Based Swap Position would be $75 million, and reporting pursuant to proposed Rule 10B–1 would not be required given that the net exposure falls below $150 million. By contrast, if a person held $250 million in bonds on ABC Corporation and purchased $325 million in CDS on those bonds, the person would be required to report that position pursuant to proposed Rule 10B–1 given that the gross Security-Based Swap Position exceeds $300 million, even though those two positions would offset each other to create a net $75 million exposure.

With respect to all other Security-Based Swap Positions based on debt securities (*i.e.,* not CDS), the Commission is proposing that the threshold be a gross notional amount of $300 million, without regard to direction of the person's CDS positions and without excluding any debt securities underlying a security-based swap included in the Security-Based Swap Position.[132] The Commission does not believe it to be appropriate to allow these positions to be netted against any underlying debt securities given that these types of security-based swap transactions operate differently than CDS transactions. For example, a CDS buyer whose security-based swaps are used to hedge some or all of their positions in an underlying bond will likely be less inclined to take actions that would result in a CDS default,

[127] As previously noted, Section 10B(d) provides the Commission with the authority to require ''any person that effects transactions for such person's own account or the account of others in any securities-based swap or uncleared security-based swap and any security or loan or group or narrow-based security index of securities or loans . . . to report such information as the Commission may prescribe regarding any position or positions in any security-based swap or uncleared security-based swap *and any security or loan or group or narrow-based security index of securities or loans and any other instrument relating to such security or loan or group or narrow-based security index of securities or loans . . .*'' *See* 15 U.S.C. 78j–2(d) (emphasis added).

[128] *See* proposed Rule 10B–1(b)(1)(i). These proposed thresholds are based, at least in part, on individual CDS exposure data from the Depository Trust and Clearing Corporation (''DTCC'') Trade Information Warehouse (''TIW''). This information is made available to the Commission voluntarily in accordance with an agreement between the DTCC–TIW and the OTC Derivatives Regulators' Forum, of which the Commission is a member. In reviewing the DTCC–TIW data, Commission staff attempted to identify notional amounts that would be low enough to capture any positions that could potentially have an effect on either the reference entity and/or the CDS or bond market (or both), yet also high enough to avoid over-reporting, which could limit the effectiveness of the rule. *See infra* section VI.D.2.iii. In developing these thresholds, staff also considered the opportunistic CDS strategies described in the relevant academic literature, and summarized in section I.C.

[129] *See supra* section I.C. Proposed Rule 10B–1(b)(1)(iv) provides that for purposes of the rule, a ''debt security underlying a security-based swap included in the Security-Based Swap Position'' means any security that could potentially be deliverable into a CDS auction in the event of a default.

[130] *See infra* section VI.D.2.iii.

[131] *See supra* note 26 and accompanying text.

[132] *See* proposed Rule 10B–1(b)(1)(ii).

given that the payment received should correspond to their losses from the bond. By contrast, a CDS buyer who does not hold the underlying bond may be incentivized to take actions that would result in a CDS default given that the resulting payment would not be offset by the buyer's losses from the bond. Such a dynamic—*i.e.,* where there are conflicting motivations as between the CDS transaction and any debt securities underlying that CDS transaction—is less likely to occur in connection with other types of security-based swaps.[133] For similar reasons, the threshold for these types of security-based swaps also does not include a lower threshold for long and short positions.

2. Reporting Threshold for Security-Based Swaps on Equity

For Security-Based Swap Positions based on equity securities, the Commission is proposing that the ''Reporting Threshold Amount'' in proposed Rule 10B–1(b)(1) be bifurcated, such that it would be defined to include both a threshold based on the notional amount of the Security-Based Swap Position, and a threshold based on the total number of shares attributable to the Security-Based Swap Position as a percentage of the outstanding number of shares of that class of equity securities. Those thresholds, which are specified below, are based on a review of all available information, including the data the Commission collects from Form N–PORT, which requires certain registered investment companies to report information about their monthly portfolio holdings to the Commission.[134] As with the threshold for Security-Based Swap Positions based on CDS, these thresholds were constructed to be low enough to capture any positions that could potentially have a significant effect on the equities markets, and potentially issuers of equity securities and their security holders, yet also high enough to avoid over-reporting, which could limit the effectiveness of the rule. In other words, the Commission has endeavored to set these thresholds at a level that should limit the reporting burden to include only those positions that are most likely to achieve the underlying purposes of the rule.

As of November 8, 2021, the Commission now has access to additional equity security-based swap transaction data from registered SBSDRs pursuant to Regulation SBSR.[135] In addition, equity securities are more widely traded in the secondary markets than debt securities, such that trading volume could be a key metric for measuring the potential market impact of a large equity swap position but not as relevant a metric for measuring the potential market impact of a large CDS position. The Commission intends to consider this newly available data in determining thresholds to use in connection with Security-Based Swap Positions based on equity securities when adopting a final rule.

Notional Threshold

Pursuant to proposed Rule 10B–1(b)(1)(iii), the term ''Reporting Threshold Amount'' with respect to Security-Based Swap Positions on equity securities is defined to mean the *lesser* of two different thresholds, one based on the notional amount of the position and one based on the percentage of outstanding of shares attributable to the position. With respect to the notional amount, a person would be required to file a Schedule 10B once a Security-Based Swap Position based on equity meets or exceeds $300 million, calculated on a gross basis (*i.e.,* including both long and short positions). However, the Commission also recognizes that people may attempt to evade the reporting requirements in proposed Rule 10B–1 by making efforts to keep a Security-Based Swap Position below the $300 million gross notional threshold, while also building up a position in the underlying equity securities and/or other types of non-security-based swap derivatives on such underlying security. Accordingly, proposed Rule 10B–1(b)(1)(iii)(A) would provide that once a Security-Based Swap Position exceeds a gross notional amount of $150 million, the calculation of the Security-Based Swap Position shall also include the value of all of the underlying equity securities owned by the holder of the Security-Based Swap Position (based on the most recent closing price of shares), as well as the delta-adjusted notional amount of any options, security futures, or any other derivative instruments based on the same class of equity securities.[136] The Commission believes that the proposed approach would provide greater transparency with respect to a person with significant exposure to a particular equity security, which includes a large Security-Based Swap Position, even if that position by itself would not be large enough to require the person to file a Schedule 10B.[137] In such instance, the total exposure could carry the same risks in terms of potential effects on the securities markets (including the market for security-based swaps) and to security-based swap counterparties as a Security-Based Swap Position that meets or exceeds the $300 million gross notional threshold.

Percentage Threshold

The Commission believes that including a second test that is based on the number of applicable shares represented by the Security-Based Swap Position is likely important for a number of reasons, particularly as it relates to security-based swaps based on equity securities issued by companies with a smaller market capitalization. Under those circumstances, the notional amount of such security-based swaps may not trigger either the $150 million or $300 million gross notional thresholds, and may not be likely to have a broad impact on the securities markets, but may represent a significant number of shares of the issuer and therefore carry the potential to impact the issuer.

A person would be required to file a Schedule 10B once the ''Security-Based Swap Equivalent Position'' (discussed

[133] *See supra* note 129 and accompanying text.

[134] *See infra* section VI.D.2.iii.

[135] *See supra* note 4. By contrast, CDS data has been voluntarily reported and available to the Commission for more than a decade.

[136] Proposed Rule 10B–1(b)(6) defines the term ''delta'' to mean the ratio that that is obtained by comparing (x) the change in the value of a derivative instrument to (y) the change in the value of the reference equity security. If a derivative instrument does not have a fixed delta, then generally the delta should be calculated on a daily basis, based on the most recent closing price of shares of the reference equity security. The Commission is not proposing a specific definition of ''delta-adjusted notional amount'' in order to allow for flexibility in how it is computed, but as a general matter the calculation should involve multiplying the notional amount of the derivative by the delta adjustment.

[137] The Commission recognizes, however, the limited value that would be obtained by including in the calculation equity securities held by an intermediary, such as a broker-dealer or a bank, in street name for the benefit of the person with the actual economic or beneficial ownership of such securities. Accordingly, proposed Rule 10B–1(b)(7) provides that for purposes of the $300 million gross notional threshold (and the 5% threshold discussed below), a person that is a member of a national securities exchange shall not be deemed to be the owner of any equity securities that they hold directly or indirectly on behalf of another person solely because such person is the record holder of such securities and, pursuant to the rules of such exchange, may direct the vote of such securities, without instruction, on other than contested matters or matters that may affect substantially the rights or privileges of the holders of the securities to be voted, but is otherwise precluded by the rules of such exchange from voting without instruction. Proposed Rule 10B–1(b)(7) is similar to existing Rule 13d–3(d)(2) under the Exchange Act, which provides a similar exclusion for purposes the beneficial ownership requirements in Sections 13(d) and (g) of the Exchange Act. *See* 17 CFR 240.13d–3(d)(2).

below) represents more than 5% of a class of equity securities.[138] People may attempt to evade the reporting requirements in proposed Rule 10B–1 by keeping a Security-Based Swap Equivalent Position below the threshold, while also building up a position in the underlying equity securities and/or other types of non-security-based swap derivatives on such underlying security. Accordingly, proposed Rule 10B–1(b)(1)(iii)(B) would provide that once a Security-Based Swap Equivalent Position represents more than 2.5% of a class of equity securities, the calculation of the Security-Based Swap Equivalent Position shall also include in the numerator all of the underlying equity securities owned by the holder of the Security-Based Swap Position, as well as the number of shares attributable to any options, security futures, or any other derivative instruments based on the same class of equity securities.

For purposes of this threshold, proposed Rule 10B–1(b)(2) would define the term ''Security-Based Swap Equivalent Position'' to mean the number of shares attributable to all of the security-based swaps composing a Security-Based Swap Position, as determined in accordance with proposed Rule 10B–1(b)(4). That rule defines the phrase ''number of shares attributable'' to a derivative instrument (including a security-based swap) to mean the *larger* of (in each case as applicable):

(i) The number of shares of the reference equity security that may be delivered upon on the exercise of the rights under the derivative instrument, as determined in accordance with the terms of the applicable documentation;

(ii) The number of shares of the reference equity security determined by multiplying (x) the number of shares by reference to which the amount payable under the derivative instrument is determined by (y) the delta of the applicable derivative instrument; and

(iii) The number of shares of the reference equity security determined by (x) dividing the notional amount of such derivative instrument by the most recent closing price of shares of the reference equity security, and then (y) multiplying such quotient by the delta of the applicable derivative instrument.[139]

The first prong of the definition is intended to apply primarily to physically settled instruments. Thus, if the applicable documentation refers to a specific number of shares of the reference security or provides a formula to determine the number of shares to be delivered, that number would be used for purposes of this prong. The second prong of the definition is intended to apply primarily to a cash-settled instruments that provide for a way to calculate the number of shares of the reference security based on the amount payable, with an adjustment to account for derivative instruments with a delta that is not equal to one. Finally, the third prong is intended to apply primarily to a cash-settled instrument where no such methodology exists. In that case, the number of shares attributable to the instrument would be calculated by dividing the notional amount of the instrument by the most recent closing price of the reference equity security, and multiplying the quotient by the delta of the instrument.

The above calculations would apply not only to all security-based swaps based on a single equity security, but also to security-based swaps based on a narrow-based security index containing that reference security. As an example, if a person has a Security-Based Swap Position consisting of security-based swaps on the common shares of XYZ Corporation and security-based swaps on a narrow-based security index that contains XYZ Corporation, the number of shares attributable to the index-based security-based swaps would need to be added to the number of shares attributable to the single-name security based swaps for purposes of calculating the percentage of those shares by reference to the number of outstanding shares. With respect to the index-based security-based swaps, if the documentation contained no methodology for calculating the number of shares of the reference equity security by reference to which the amount payable under the derivative instrument is determined, the third prong of proposed Rule 10B–1(b)(4) would apply. Thus, if the notional amount of security-based swaps based on the index was $100 million, and XYZ Corporation common stock constituted 40% of the index, the notional amount for these purposes would be $40 million, which would then be divided by the most recent closing price of XYZ Corporation common stock to determine the number of shares attributable to the index-based security-based swaps.[140]

3. Amendments to a Previously Filed Schedule 10B

Proposed Rule 10B–1(c) would require a person who has previously filed a Schedule 10B with the Commission to file an amendment if any material change occurs in the facts set forth in a previously filed Schedule 10B including, but not limited to, any material increase in the Security-Based Swap Positions or if a Security-Based Swap Position falls back below the applicable Reporting Threshold Amount. Any such amendment would be required to be filed on EDGAR promptly, but in no event later than the end of the first business day following the material change.

For purposes of the proposed rule, an acquisition or disposition in an amount equal to 10% or more of the position previously disclosed in Schedule 10B would be deemed ''material'' for purposes of this requirement. The Commission believes that this requirement will help ensure that regulators and market participants continue to have updated information about reportable Security-Based Swap Positions, but only so far as the updated information is material. Accordingly, proposed Rule 10B–1(c) would require a person who has previously filed a Schedule 10B to file an amendment if the amount of the Security-Based Swap Position that was previously reported increases or decreases by 10% or more. The Commission welcomes and encourages comments as to when commenters believe that an amendment should be required to be filed, any thresholds used to make such a determination, and the timeframe for making such submission.

[138] Because the definition of ''Reporting Threshold Amount'' with respect to Security-Based Swap Positions on equity securities is defined in proposed Rule 10B–1(b)(1)(iii) to mean the *lesser* of two different thresholds, one based on the notional amount of the position and one based on the percentage of outstanding shares attributable to the position, the applicable Security-Based Swap Position may have already exceeded the notional threshold. To the extent that the holder of such Security-Based Swap Position has already filed the applicable Schedule 10B with the Commission, such person would not need to file a new or amended Schedule 10B if the position subsequently exceeds the percentage threshold (or vice versa), unless an amendment to the previously-filed Schedule 10B is required pursuant to proposed Rule 10B–1(c). *See infra* section III.A.iii.

[139] Proposed Rule 10B–1(b)(4) defines the phrase ''number of shares attributable to'' for purposes of proposed Rule 10B–1(b)(2), which relates to determining the number for shares attributable to the Security-Based Swap Position when calculating the ''Security-Based Swap Equivalent Position'' and for purposes of proposed Rule 10B–1(b)(1)(iii)(B), which relates to determining the number of shares attributable to other derivatives that would be required to be added to a Security-Based Swap Equivalent Position that represents more than 2.5% of a class of equity securities.

[140] This assumes that the delta of the applicable security-based swaps was one. If not, or if the relevant instrument was one that is generally not a delta one derivative (*e.g.,* an option), the number of shares resulting from the calculation would then need to be multiplied by the delta.

B. Information Required To Be Included in Schedule 10B

Pursuant to proposed Schedule 10B, persons subject to the proposed rule would be required to report the following information:

(1) Name of reporting person (or names of reporting persons if making a joint filing as a group), whether reporting person is a member of a group and names of the members of the group if the members of the group are satisfying the group's Rule 10B–1(a)(1) filing obligation by making individual filings.

(2) Residency or place of organization of the reporting person(s).

(3) Type of reporting person(s).

(4) For reporting persons that are legal entities, the Legal Entity Identifier (''LEI'') of the reporting person, if such person has an LEI.

(5) Notional amount of the applicable Security-Based Swap Position(s) of the reporting person, along with summary information about the composition of the position as it relates to the direction (*i.e.,* long or short) and the tenor/expiration of the underlying security-based swap transactions and the product ID (such as the Unique Product Identifier, or ''UPI'') of the security-based swap(s) included in the Security-Based Swap Position, if applicable.

(6) In the case of a Security-Based Swap Position based on debt securities (including credit default swaps), ownership of: (i) All debt securities underlying a security-based swap included in the Security-Based Swap Position, including the Financial Instrument Global Identifier (''FIGI'') of each underlying debt security, if applicable, and the LEI of the issuer of each underlying debt security, if the issuer has an LEI; and (ii) all security-based swaps based on equity securities issued by the same reference entity, including the FIGI of each underlying equity security, if applicable. In addition to the FIGI, other unique security identifier(s) may be included at the filer's option.

(7) In the case of a Security-Based Swap Position based on equity securities, ownership of: (i) All equity securities underlying a security-based swap included in the Security-Based Swap Position, including the FIGI of each underlying equity security and the LEI of the issuer of each underlying equity security, if the issuer has an LEI; and (ii) all security-based swaps based on debt securities issued by the same reference entity (including credit default swaps), including the FIGI of each underlying debt security, if applicable. In addition to the FIGI, other unique security identifier(s) may be included at the filer's option.

(8) Ownership of any other instrument relating to the Security-Based Swap Position and/or any underlying security or loan or group or index of securities or loans, or any security or group or index of securities, the price, yield, value, or volatility of which, or of which any interest therein, is the basis for a material term of a security-based swap included in the Security-Based Swap Position, if not otherwise disclosed pursuant to Items 6 or 7 of this form. For any underlying security disclosed pursuant to this Item, disclose the FIGI of the security, if applicable, and the LEI of the issuer of the security, if the issuer has an LEI. In addition to the FIGI, other unique security identifier(s) may be included at the filer's option.

(9) To the extent that the Reporting Threshold Amount is based on the number of shares corresponding to a Security-Based Swap Position based on equity securities, the number of shares attributable to the Security-Based Swap Position, along with the closing price used in the calculation and the date of such closing price.

The first four items relate to the identity of the reporting person. With respect to item (3), the reference to ''type'' of reporting person would include the following categories: (i) Broker-dealer; (ii) security-based swap dealer or major security-based swap participant; (iii) bank; (iv) insurance company; (v) investment company; (vi) investment adviser; (vii) employee benefit plan or endowment fund; (viii) parent holding company/control person; (ix) savings association; (x) church plan; (xi) corporation; (xii) partnership; (xiii) individual; and (xiv) other. These categories are identical to those included in Schedule 13D, other than the addition of SBS Entities in item (ii).[141]

Items (5) through (8) require reporting of the Security-Based Swap Position, the loans or securities underlying that position, any related securities and loans, and other security-based swaps related to the applicable Security-Based Swap Position.[142] Item (9) applies only to Security-Based Swap Positions based on equity securities where the Reporting Threshold Amount is based on the number of shares corresponding to a Security-Based Swap Position and is intended to provide basic information as to how the number of shares was calculated.

At the same time, however, the Commission also understands that certain aspects of a security-based swap transaction may be sensitive or proprietary information. As previously noted, the intent of proposed Rule 10B–1 is to alert regulators and the market, including counterparties to security-based swap trades and the companies whose securities underlie security-based swaps, that one or more market participants are amassing a large position in security-based swaps. The items listed above are intended to achieve that objective without requiring market participants to publicly disclose sensitive or proprietary information about their Security-Based Swap Positions. In particular, Schedule 10B does not require reporting persons to disclose any information about their counterparties, including their identities, to any security-based swap or other related derivatives; only the aggregated positions would need to be disclosed. Moreover, Schedule 10B only requires reporting persons to include a ''brief description'' of any contracts, arrangements, understandings or relationships with respect to any security-based swaps included in the Security-Based Swap Position or any underlying or related securities (including security-based swaps) or loans required to be disclosed pursuant the form; the agreements themselves would not need to be disclosed. The Commission believes that structuring Schedule 10B in such a manner would help to alleviate concerns regarding the potential public disclosure of sensitive or proprietary information, and we encourage commenters to provide information as to whether the Commission should take any additional measures to accomplish that goal, consistent with the underlying objectives of proposed Rule 10B–1.

Finally, proposed Rule 10B–1(e) would provide that if some or all of the information required to be disclosed on proposed Schedule 10B is publicly available on EDGAR at the time the Schedule 10B is required to be filed, such information may be incorporated by reference in answer, or partial answer, to any item of Schedule 10B. This provision is intended to make the proposed rule more efficient in cases where any required information is publicly available on EDGAR. In such cases, the Schedule 10B need only cite to the filing where the information can be found.[143]

[141] *See* 17 CFR 240.13d–101.

[142] As previously explained, for purposes of the definition of ''Security-Based Swap Position,'' security-based swaps based on equity securities issued by a reference entity would constitute a separate Security-Based Swap Position as compared to security-based swaps based on debt securities of the same reference entity. *See supra* note 125 and accompanying text. As a result, if a reporting party had a Security-Based Swap Position composed of security-based swaps based on equity securities and separate security-based swaps based on debt securities of the same issuer, the Security-Based Position would be disclosed pursuant to Item (5), and the debt security-based swaps would be disclosed pursuant to Item (6). In the reverse scenario, a Security-Based Position composed of security-based swaps based on debt securities would be disclosed pursuant to Item (5), and the equity security-based swaps would be disclosed pursuant to Item (7). Item (8) would include any other instrument relating to the Security-Based Swap Position and/or any underlying security or loan or group or index of securities or loans.

[143] The Commission has previously allowed people subject to reporting and other disclosure obligations to incorporate certain information by reference into those filings. *See e.g.,* Rule 12b–23 under the Exchange Act, which establishes requirements for incorporating information by

Continued

C. Cross-Border Issues

As the Commission has stated in prior releases, security-based swap transactions currently take place across national borders, with agreements negotiated and executed between counterparties in different jurisdictions (which might then be booked and risk-managed in still other jurisdictions).[144] Given the global nature of the security-based swap market, an effective application of proposed Rule 10B–1 necessitates identifying which transactions in this global market will be subject to these reporting requirements.

To achieve that objective, proposed Rule 10B–1(d) would provide that the reporting requirements of the rule would apply to all Security-Based Swap Positions so long as: (1) Any of the transactions that compose the Security-Based Swap Position would be required to be reported pursuant to 17 CFR 242.908 (''Rule 908'') of Regulation SBSR; [145] or (2) the reporting person holds any amount of reference securities underlying the Security-Based Swap Position (or would be deemed to be the beneficial owner of such reference securities, pursuant to Section 13(d) of the Exchange Act and the rules and regulations thereunder) and: (i) The issuer of such reference security is a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the U.S. or having its principal place of business in the U.S.; or (ii) such reference security is part of a class of securities registered under Section 12 or 15(d) of the Exchange Act.[146]

Rule 908(a) provides that a security-based swap is subject to regulatory reporting and public dissemination if: (i) There is a direct or indirect counterparty that is a U.S. person on either or both sides of the transaction; or (ii) the security-based swap is accepted for clearing by a clearing agency having its principal place of business in the United States.[147] The rule also provides that a security-based swap that is not included in the above provisions is subject to regulatory reporting but not public dissemination if there is a direct or indirect counterparty on either or both sides of the transaction that is a registered security-based swap dealer or a registered major security-based swap participant.[148]

The Commission believes that tying the reporting requirements in proposed Rule 10B–1 to the regulatory reporting and public dissemination requirements in Regulation SBSR is appropriate for similar reasons set forth when Rule 908 was adopted. Specifically, the Commission at the time explained that when a U.S. person enters into a security-based swap, the security-based swap necessarily exists at least in part within the United States, such that requiring regulatory reporting and requiring public dissemination would be consistent with the Commission's territorial approach in a number of areas, including the application of Title VII requirements.[149]

In addition to tying the reporting requirement in proposed Rule 10B–1 to regulatory reporting and public dissemination, the proposed rule also would apply when the reporting person holds any amount of reference securities underlying the Security-Based Swap Position (or would be deemed to be the beneficial owners of such reference securities, pursuant to Section 13(d) of the Exchange Act and the rules and regulations thereunder) and: (i) The issuer of such reference security is a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the U.S. or having its principal place of business in the U.S.; or (ii) such reference security is part of a class of securities registered under Section 12 or 15(d) of the Exchange Act.[150] As explained above, the Commission has previously applied a territorial approach to the application of Title VII—including the requirements relating to regulatory reporting and public dissemination of security-based swap transactions—that is grounded in the text of the relevant statutory provisions and is designed to help ensure that the Commission's application of the relevant provisions is consistent with the goals that the statute was intended to achieve.[151] Under this approach, the first step is to identify the congressional focus of the statutory provision. If the activity that is the focus of the statutory provision occurs here, then application of the statutory provision to that activity is a permissible domestic application of the statute. When the statutory text provides for further Commission interpretation of statutory terms or requirements, this analysis may require the Commission to identify through rulemaking or other regulatory action, a reasonable understanding (which may look to prior interpretations of the relevant statutory text) the specific activity that is relevant under the statute.[152]

Section 10B generally provides the Commission with authority to require any person effecting transactions for such person's own account or the account of others in any security-based swap and any underlying security or loan or group or index of securities or loans (as well as any related securities) to report such information as the Commission may prescribe regarding any position or positions in any security-based swap and any underlying or related securities, loans, or indexes.[153] In considering this statutory text, the Commission understands that a congressional focus of Section 10B to be the promotion of transparency through disclosure within the U.S. securities markets of security-based swap positions that (at least in part) occur in the United States or other security-based swap transactions that involve persons who have positions in U.S. issuers or U.S. registrants. This congressional focus is reasonably understood to include U.S. security-based swaps that are at least partially within the U.S.

reference into any Commission registration statement or report filed pursuant to Sections 12(b) and 12(g), 13 or 15(d) of the Exchange Act. 17 CFR 240.12b–21 and 12b–23. Consistent with Exchange Act Rule 12b–23, information cannot be incorporated by reference if such incorporation would make the disclosure incomplete, unclear, or confusing.

[144] *See* 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 30968, 30976 n. 48 and accompanying text (May 23, 2013).

[145] *See* 17 CFR 242.908.

[146] *See* proposed Rule 10B–1(d).

[147] *See* 17 CFR 242.908(a). Rule 908 defines ''U.S. person'' by cross-referencing to 17 CFR 240.3a71–3(a)(4) (''Rule 3a71–3(a)(4)'') of the Exchange Act, which provides that, subject to certain exceptions, a ''U.S. person'' means any person that is: (i) A natural person resident in the United States; (ii) a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States; (iii) an account (whether discretionary or non-discretionary) of a U.S. person; or (iv) an estate of a decedent who was a resident of the United States at the time of death. *See* 17 CFR 240.3a71–3(a)(4).

[148] *See* 17 CFR 242.908(a).

[149] *See* 2015 Regulation SBSR Adopting Release, 80 FR at 14649–14650.

[150] *See* proposed Rule 10B–1(d).

[151] *See* 2015 Regulation SBSR Adopting Release, 80 FR at 14649–14650, n. 790 (citing *Morrison* v. *Nat'l Australia Bank, Ltd.,* 130 S. Ct. 2869, 2884 (2010) (explaining that in order to determine whether a particular application of a statutory provision is a domestic application of that provision, it is necessary to identify the congressional focus of the statutory provision and then determine whether the subject the congressional focus is in the United States or overseas)).

[152] *See* 2015 Regulation SBSR Adopting Release, 80 FR at 14649–14650, n. 791 and accompanying text.

[153] *See* 15 U.S.C. 78j–2.

securities markets or any other securities that trade within the U.S. securities markets where at least one party has an ownership interest in any of the underlying or related U.S. securities or loans. This understanding of the congressional focus is based in part on the fact that paragraph (a) of Section 10B applies to the Commission's authority to establish position limits in security-based swaps (on which the Commission has not yet acted), and paragraph (d), which is titled ''Large Trader Reporting'' applies to the Commission's authority to promulgate rules regarding reporting of positions in security-based swaps.[154]

The proposed rule would apply when the reporting person holds any amount of reference securities underlying the Security-Based Swap Position (or would be deemed to be the beneficial owner of such reference securities, pursuant to Section 13(d) of the Exchange Act and the rules and regulations thereunder), so long as one of two conditions are satisfied.[155] In particular, such underlying securities or loans must either be: (1) Issued by an entity subject to U.S. jurisdiction (*i.e.,* such issuer is either a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the U.S. or having its principal place of business in the U.S.) or (2) subject to ongoing reporting obligations under the Federal securities laws (*i.e.,* Section 12 or 15(d) of the Exchange Act).[156]

[154] *See id.* Paragraph (d) of Section 10B provides the Commission with authority to require reporting of positions by any person that ''effects transactions for such person's own account or the account of others.'' That provision incorporates paragraph (a) to define the scope of the security-based swaps and other related securities that would be subject to the reporting requirement. Notably, paragraphs (a)(1) and (2) of Section 10B focus on the Commission's authority to establish position limits in security-based swaps and related securities as necessary and appropriate in the public interest or for the protection of investors, does not focus on where the transactions underlying those positions were ''effected.''

[155] In particular, Rule 13d–3 under the Exchange Act, which was adopted pursuant to Section 13(d), establishes the standards for determining when a person is the beneficial owner of a relevant security. Among other things, that rule provides that for the purposes of Sections 13(d) and 13(g), a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares: (1) Voting power which includes the power to vote, or to direct the voting of, such security; and/or, (2) investment power which includes the power to dispose, or to direct the disposition of, such security. *See* 17 CFR 240.13d–3(a).

[156] *See* 15 U.S.C. 78l or 78o(d).

D. Structured Data Requirement for Schedule 10B

To facilitate analysis of the reports submitted on Schedule 10B via EDGAR, the Commission is proposing to require filers to submit Schedule 10B using a structured, machine-readable data language. In particular, the Commission is proposing that Schedule 10B be structured using Financial Information eXchange Markup Language (''FIXML''), a structured data language built on the open Financial Information eXchange (''FIX'') standard used by market participants to communicate information about securities transactions and markets to each other.[157]

The Commission believes a FIXML requirement for Schedule 10B will further the goal of increasing transparency in the security-based swaps market. Because the reports on Schedule 10B would be publicly available in a machine-readable data language, the information disclosed by filing persons would be much more readily accessible and usable for extraction, filtering, comparison, threshold notification, and other analyses on a large scale by the public and the Commission.

To allow for flexibility in complying with this requirement, the Commission would provide filing persons with a fillable web form that would convert inputted reports into FIXML, allowing filers to, at their option, either submit Schedule 10B directly in FIXML, or use the fillable web form to generate the Schedule 10B in FIXML.[158] In addition, the Commission would develop electronic ''style sheets'' that, when applied to the reported FIXML data on Schedule 10B, would represent that data in human-readable form.

E. Request for Comment

The Commission generally requests comments on all aspects of proposed Rule 10B–1. In addition, the Commission requests comments on the following specific issues:

- Should the Commission utilize its authority under Section 10B(d) of the Exchange Act to require public reporting of certain Security-Based Swap Positions, any security or loan or group or index of securities or loans underlying the Security-Based Swap Position, and any other instrument relating to such security or loan or group or index of securities or loans? Why or why not?
- Do commenters agree with the requirement that the Schedule 10B be filed promptly, but in any event no later than the end of the first business day following the day of execution of the security-based swap transaction that results in the Security-Based Swap Position first exceeding the Reporting Threshold Amount? Does that timing allow for sufficient time to perform the calculations necessary to determine whether a Schedule 10B must be filed or amended and to ensure that the form contains all of the required information? Why or why not? If commenters disagree with the proposed timing, what alternative timeframe should be used for purposes of the proposed rule and why?
- Do commenters agree with the scope of the definition of ''Security-Based Swap Position,'' which determines which security-based swaps should be aggregated for purposes of determining when reporting is required and the security-based swaps that must be disclosed? Why or why not? Should this definition be amended in any way? If so, how should the definition be modified and why?
- Should the definition of ''Security-Based Swap Position'' aggregate only security-based swaps of the same type (*i.e.,* security-based swaps based on equity securities *or* security-based swaps based on debt (including CDS)) and the same underlying security or reference entity? Why or why not? If not, should a Security-Based Swap Position include all security-based swaps based on the same underlying security or reference entity, regardless of whether they are debt (including CDS) or equity-based? Similarly, should a Security-Based Swap Position include all security-based swaps on the same underlying security or reference entity, as well as similar or related securities or reference entities? If so, how should the proposed rule define what is ''similar'' for these purposes?
- Should proposed Rule 10B–1 require reporting of large positions in security-based swaps, regardless of the underlying reference entity, security, loan, or group or index of securities or loans that a person has with all their counterparties, as a means of identifying persons with positions large enough to have a material impact on the securities markets in general? Why or why not? For example, 17 CFR 240.13h–1 (''Rule 13h–1'') requires traders who engage in a substantial level of trading activity to identify themselves to the Commission by filing a Form 13H with the Commission. Pursuant to Rule 13h–1, a ''large trader'' includes a person whose transactions in exchange-listed securities equal or exceed two million shares or $20 million during any calendar day, or 20 million shares or $200 million during any calendar month. Those thresholds are calculated based on the trader's entire position in all NMS securities, as opposed to its positions in the securities of the same

[157] FIXML and the underlying FIX communications protocol is maintained by the FIX Trading Community, a not-for-profit industry-driven standards-setting body. Current FIXML uses include derivatives post-trade clearing, settlement, and reporting. More information about FIXML and the FIX Trading Community is available at the ''FIXML'' and ''FIX Trading Community'' web pages on the FIX Trading website (*available at: https://www.fixtrading.org/standards/fixml/* and *https://www.fixtrading.org/overview/*).

[158] *See* EDGAR Filer Manual (Volume II) version 59 (September 2021), Chapter 8 (discussing the preparation and transmission of online submissions to the EDGAR system).

issuer. Should the Commission consider adopting a similar requirement for positions in security-based swaps? Why or why not?

- Should proposed Rule 10B–1 require that persons subject to the reporting requirement of the rule submit Schedule 10B on EDGAR? Why or why not? Should the rule require or permit a different means of submitting Schedule 10B, either in lieu of, or in addition to, EDGAR? If so, how should the form be submitted and why? Also, how would such additional or substitute means of submission satisfy the objective of Rule 10B–1 to make the information included in Schedule 10B publicly available?
- Should the Commission require Schedule 10B to be submitted in a structured data language? Why or why not? If so, is the proposed FIXML data language the most appropriate structured data language to use for Schedule 10B, or would another structured data language be more appropriate? If the latter, please specify the structured data language that would be more appropriate for Schedule 10B, and explain why.
- Do commenters agree with the proposed definition of ''Reporting Threshold Amount'' in the context of CDS? Why or why not? Is basing the reporting requirement in proposed Rule 10B–1 on the notional amount of CDS positions appropriate? Why or why not? Is there a better method for triggering the requirement? If so, what method should be used and why? Are the proposed $150 million long, $150 million short, and $300 million gross notional thresholds for CDS positions appropriate? Why or why not? Should the Commission further specify which debt securities would be permitted to be netted against the aggregate long CDS position? Should additional types of netting be permitted, such as by allowing additional types of securities to be netted against the aggregate CDS position or by allowing long and short CDS transactions to net against each other? Should the rule permit people to net their short positions in deliverable bonds against their short CDS positions? Why or why not? To the extent that commenters believe that additional netting should be permitted, please provide as much detail as possible as to any limitations in scope or amount that should be included in the calculation and why such limitations should be included?
- Do commenters agree with the proposed definition of ''Reporting Threshold Amount'' in the context of security-based swaps on debt securities that are not CDS? Why or why not? Is basing the reporting requirement in proposed Rule 10B–1 on the notional amount of the position appropriate? Why or why not? Is there a better method for triggering the requirement? If so, what method should be used and why? Is the proposed threshold of $300 million on a gross notional basis appropriate? Why or why not? Should proposed Rule 10B–1 allow for netting when calculating the Security-Based Swap Position on debt security-based swaps, such as by allowing any underlying or related debt securities to be netted against the aggregate position or by allowing long and short security-based swap transactions to net against each other? To the extent that commenters believe that netting should be permitted, please provide as much detail as possible as to any limitations in scope or amount that should be included in the calculation and why such limitations should be included.
- Should the proposed definition of ''Reporting Threshold Amount'' in the context of either CDS or security-based swaps based on debt securities that are not CDS (or both) also include a percentage threshold, similar to what the Commission proposed in the context of security-based swaps based equity securities, in order to account for smaller issuers of debt? Why or why not? If commenters believe that such an approach would be useful for CDS, should the threshold be based on the outstanding number of potentially deliverable obligations or the outstanding amount of CDS? Commenters are encouraged to be as specific as possible in explaining how such a test would work.
- Do commenters agree with the proposed definition of ''Reporting Threshold Amount'' in the context of security-based swaps on equity securities, including having both a threshold based on the notional amount of the Security-Based Swap Position and a threshold based on the number of shares attributable to the Security-Based Swap Position? Why or why not? Do commenters agree with the proposed $300 million and 5% thresholds? If not, how should they be modified? Should the Commission require people to include all related securities in the calculation of their Security-Based Swap Positions once they exceed an intermediate threshold in order to prevent evasion? If commenters agree with this approach, are $150 million and 2.5% appropriate thresholds to use for these purposes? Why or why not?
- Should the Commission consider a different methodology for purposes of the definition of ''Reporting Threshold Amount'' in the context of security-based swaps on equity securities? For example, should proposed Rule 10B–1 include a threshold based on number of shares represented by the Security-Based Swap Position as a percentage of the average daily trading volume of those shares, as measured by the number of shares traded and calculated over a fixed period (*e.g.,* the preceding six months)?
- Do commenters agree with the proposed requirements regarding the submission of amendments to Schedule 10B, as set forth in proposed Rule 10B–1(c), including the 10% threshold for increases or decreases of the Security-Based Swap Position? Why or why not? If not, what should be modified and why?
- Do commenters agree with information the Commission is proposing to be required to be disclosed on Schedule 10B? Why or why not? Should other information be required? If so, what information should be added and why? Should information currently proposed to be included not be required? If so, what information should be deleted from the proposed schedule and why?
- Do commenters agree with the Commission's proposal not to require reporting of a reporting party's counterparties? Why or why not? How much does the absence of counterparty information impact the usefulness of the reporting? Is there any other information that should not be required to be disclosed on Schedule 10B due to it being sensitive or proprietary in nature? If so, what information should not be disclosed and why?
- In cases where a Schedule 10B filing is made for a group of persons, should the Commission require any additional information about the group, such as a brief description of any contracts, arrangements, understandings or relationships among the persons in the group, as set forth in Item (10) of proposed Schedule 10B? Why or why not? What other information should be included?
- Do commenters agree with the form and scope of proposed Rule 10B–1(d), which would identify when the reporting requirements of the rule would apply to all Security-Based Swap Positions, including in the context of cross-border security-based swap transactions? Why or why not? Are there any changes to the proposal that the Commission should make to modify the scope of the positions that would be subject to the rule? If so, what changes should be made and why?
- Proposed Rule 10B–1(e) would provide that if some or all of the information required to be disclosed on proposed Schedule 10B is publicly available on EDGAR at the time the Schedule 10B is required to be filed, such information may be incorporated by reference in answer, or partial answer, to any item of Schedule 10B. Should the Commission allow reporting persons to incorporate information by reference in proposed Schedule 10B? Why or why not? Should proposed Rule 10B–1(e) be modified in any way? If so, how? Are there any aspects of this proposal that should be modified or added to help make the filing requirement under proposed Schedule 10B more efficient? If so, which ones and why? If the Commission were to adopt this provision, do commenters anticipate that large portions of these filings would be incorporated by reference? If so, what burdens, if any, could this provision create for persons utilizing the data reported in the schedule?

IV. General Request for Comment

We request and encourage any interested person to submit comments regarding the proposed rules, specific issues discussed in this release, and other matters that may have an effect on the proposed rules. With regard to any comments, we note that such comments are of particular assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

V. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (''PRA'') [159] imposes certain requirements on Federal agencies in connection with the conducting or sponsoring of any ''collection of

[159] 44 U.S.C. 3501 *et seq.*

information.'' [160] For example, 44 U.S.C. 3507(a)(1)(D) provides that before adopting (or revising) a collection of information requirement, an agency must, among other things, publish a notice in the **Federal Register** stating that the agency has submitted the proposed collection of information to the Office of Management and Budget (''OMB'') and setting forth certain required information, including: (1) A title for the collection information; (2) a summary of the collected information; (3) a brief description of the need for the information and the proposed use of the information; (4) a description of the likely respondents and proposed frequency of response to the collection of information; (5) an estimate of the paperwork burden that shall result from the collection of information; and (6) notice that comments may be submitted to the agency and director of OMB.[161]

Certain provisions of the proposed rules contain ''collection of information'' requirements within the meaning of the PRA. The Commission is submitting these collections of information to OMB for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Specifically, proposed Rule 10B–1 (including Schedule 10B) would impose new collection of information requirements.[162] The title of the new collections of information is ''Schedule 10B—Reporting of Security-Based Swap Positions.'' OMB has not yet assigned a control number to this new collection of information. The Commission is not proposing to amend the collection of information entitled ''Form ID'' (OMB Control No. 3235–0328).[163]

A. Summary of Collections of Information

Proposed Rule 10B–1(a)(1) would require any person (and any entity controlling, controlled by or under common control with such person), or group of persons, who through any contract, arrangement, understanding or relationship, after acquiring or selling directly or indirectly, any security-based swap, is directly or indirectly the owner or seller of a Security-Based Swap Position [164] that exceeds the Reporting Threshold Amount, [165] shall file with the Commission a statement containing the information required by Schedule 10B using EDGAR in FIXML. Pursuant to proposed Rule 10B–1(a)(2), each person subject to the rule would be required to file its Schedule 10B promptly, but in no event later than the end of the first business day following the day of execution of the security-based swap transaction that results in the Security-Based Swap Position first exceeding the Reporting Threshold Amount.

Proposed Rule 10B–1(c) would require a person who has previously filed a Schedule 10B with the Commission to file an amendment if any material change occurs in the facts set forth in a previously filed Schedule 10B including, but not limited to, any material increase in the Security-Based Swap Positions or if a Security-Based Swap Position falls back below the applicable Reporting Threshold Amount. Any such amendment would be required to be filed on EDGAR promptly, but in no event later than the end of the first business day following the material change. Moreover, for purposes of the proposed rule, an acquisition in an amount equal to 10% or more of the position previously disclosed in Schedule 10B would be deemed ''material'' for purposes of this requirement.

Pursuant to proposed Schedule 10B, persons subject to proposed Rule 10B–1 would generally be required to report, among other things, certain information about their Security-Based Swap Positions, as well as positions in any security or loan underlying the Security-Based Swap Position, and positions in any other instrument relating to the underlying security or loan or group or index of securities or loans.[166] Schedule 10B also generally requires information regarding the identity and type of the applicable reporting person or group of persons.[167]

B. Proposed Use of Information

The Commission believes that the information required to be disclosed on Schedule 10B will be used as follows: (1) To provide market participants (including counterparties, issuers and their stakeholders) and regulators with access to information that may indicate that a person (or a group of persons) is building up a large security-based swap position, which in some cases could be indicative of potentially fraudulent or manipulative purposes; (2) to alert market participants and regulators to the existence of concentrated exposures to a limited number of counterparties, which should inform those market participants

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[160] *See* 44 U.S.C. 3502(3).

[161] *See* 44 U.S.C. 3507(a)(1)(D); *see also* 5 CFR 1320.5(a)(1)(iv).

[162] The Commission does not believe that re-proposed Rule 9j–h1 or proposed Rule 15Fh–4(c) contain a collection of information requirement within the meaning of the PRA. Specifically, re-proposed Rule 9j–1 contains prohibitions designed to prevent fraud, manipulation, and deception in connection with effecting transactions in, or inducing or attempting to induce the purchase or sale of, any security-based swap. Proposed Rule 15Fh–4(c) would generally make 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. *See* Business Conduct Standards Adopting Release, 81 FR at 30094. Given that both re-proposed Rule 9j–1 and proposed Rule 15Fh–4(c) are intended solely to identify actions that 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.

[163] To the extent that a person subject to a reporting requirement pursuant to proposed Rule 10B–1 has not previously made at least one filing with the Commission via EDGAR, such person would need to file a Form ID with the Commission in order to gain access to EDGAR. Form ID is used to request the assignment of access codes to file on EDGAR. Upon successfully filing a Form ID, a person will be provided with, among other things, a given a Central Index Key (''CIK'') number that uniquely identifies each filer. Given that the thresholds in proposed Rule 10B–1 are set at a level that will likely only capture persons previously subject to an EDGAR filing requirement (such as, among others, SBS Entities, large traders, broker-dealers, or Exchange Act reporting companies), the Commission estimates that most, if not all, persons required to submit a Schedule 10B will already have a CIK and the ability to access EDGAR. Thus, the Commission believes that the proposed rules would not impose substantive new burdens on the overall population of respondents or affect the current overall cost estimates for Form ID. Therefore, we believe that the current burden and cost estimates for Form ID remain appropriate. Accordingly, we are not revising the current burden or cost estimates for Form ID.

[164] *See supra* notes 120–121 and accompanying text (describing proposed Rule 10B–1(b)(3), which defines the term ''Security-Based Swap Position'').

[165] Proposed Rule 10B–1 would include specific quantitative thresholds for when reporting would be required. *See supra* sections III.A.1 (defining ''Reporting Threshold Amount'' for purposes of Security-Based Swap Positions consisting of CDS and other security-based swaps based on debt securities) and III.A.2 (defining ''Reporting Threshold Amount'' for purposes of Security-Based Swap Positions consisting of security-based swaps based on equity securities).

[166] *See supra* section III.B.

[167] *See id.*

and regulators of the attendant risks, allow counterparties to risk manage and lead to better pricing of the security-based swaps (as a result of all market participants having access to the information about the positions), and (3) in the case of manufactured or other opportunistic strategies in the CDS market, to provide market participants and regulators with advance notice that a person (or a group of persons) is building up a large CDS position with an incentive to vote against their interests as a debt holder, possibly with an intent to harm the company, even if such conduct is not inherently fraudulent.

C. Respondents

Based on the information in Figure 6 in section VI.D.2.iii.(A) (Economic Analysis), the Commission believes that up to 400 persons will be required to file at least one Schedule 10B with the Commission with respect to Security-Based Swap Positions consisting of CDS annually. Because reporting transaction data regarding other types of security-based swaps has only recently become mandatory, the Commission does not yet have a precise estimate as to the number of persons we would expect to file reports with respect to Security-Based Swap Positions consisting of security-based swaps based on equity securities and other debt securities (non-CDS).

However, in describing the security-based swap market as a whole, the Commission has previously stated that it believes that single-name CDS contracts make up a majority of that market.[168] Thus, the Commission expects that the number of persons that would submit reports with respect to Security-Based Swap Positions consisting of security-based swaps based on equity securities and other debt securities should not exceed the 400 persons we expect to submit reports related to CDS positions annually. Although the Commission recognizes that there is likely to a considerable number of people who will have both equity- and debt-based Security Based Swap Positions that will be required to be reported, to be conservative, the Commission is doubling the estimate; we estimate the total number of persons who will be subject to the proposed rule. Accordingly, the Commission estimates that 800 respondents will be subject to at least one reporting requirement pursuant to proposed Rule 10B–1 annually.

At the same time, however, the Commission also understands that some number of persons may have Security-Based Swap Positions that, while not large enough to trigger a reporting requirement under proposed Rule 10B–1, will be close enough to the threshold to warrant active monitoring of those positions. Accordingly, the Commission estimates that 850 respondents will likely need to develop a technological infrastructure to monitor their Security-Based Swap Positions, which includes the 800 respondents estimated to be subject to a reporting requirement pursuant to proposed Rule 10B–1 and an additional 50 respondents whose positions may not ever trigger a reporting requirement.

D. Total Annual Recordkeeping Burden

1. Initial Costs and Burdens

As discussed above, the Commission believes that up to 850 respondents will likely need to develop a technological infrastructure to calculate and monitor their Security-Based Swap Positions, even if some of those entities do not have at least one Security-Based Swap Position that is required to be reported pursuant to proposed Rule 10B–1(a). The Commission believes that most, if not all, persons who are likely to have Security-Based Swap Positions large enough to trigger the reporting thresholds will have the resources to develop and implement this technological infrastructure using internal personnel and resources. The Commission also believes that each respondent will incur a one-time initial internal burden of approximately 355 hours (or $101,740) per respondent to develop such technological infrastructure, which amounts to 301,750 hours (or $86,479,000) in the aggregate for all 850 respondents.[169] These estimates are similar to the estimates the Commission used in connection with Regulation SBSR.[170] Although the Commission recognizes that the system referred to in the Regulation SBSR Adopting Release involved capturing security-based swap transaction data, whereas the requirement in proposed Rule 10B–1 relates to aggregated security-based swap positions (as well as related securities that are not security-based swaps), we also believe that the costs of each system, regardless of whether it collects transaction or position data are sufficiently similar.

Because many of these 850 respondents may also be reporting parties pursuant to Regulation SBSR, it is possible that such persons may be able to leverage some of the technology used in connection with the transaction reporting system to build the system necessary to comply with proposed Rule 10B–1. Nevertheless, the Commission believes it appropriate to use the more conservative estimate in this proposing release given that the Commission has not previously proposed or adopted position reporting requirements with respect to security-based swaps.

2. Ongoing Costs and Burdens

In addition to developing the technological infrastructure to calculate and monitor their Security-Based Swap Positions in order to comply with the requirements of proposed Rule 10B–1, each respondent will be required to maintain and operate such system on an ongoing basis. As before, the Commission believes that the persons who are likely to be subject to the rule will likely have the personnel and resources to maintain these systems internally. As such, the Commission estimates that reach respondent will incur an annual internal burden of 436 hours (or $77,000), which amounts to 370,600 hours (or $65,450,000) in the aggregate for all 850 respondents.[171]

In addition to maintaining and operating such technological infrastructure, the Commission also believes that each respondent will incur a $1,000 annual internal cost for the technology necessary to store such security-based swap position data, or $850,000 in the aggregate for all 850 respondents.[172] As before, these estimates are similar to the estimates the

[168] *See* Risk Mitigation Adopting Release, 85 FR at 6391–92.

[169] This estimate is based on the following internal costs: [(Sr. Programmer (160 hours) at $303 per hour) + (Sr. Systems Analyst (160 hours) at $260 per hour) + (Compliance Manager (10 hours) at $283 per hour) + (Director of Compliance (5 hours) at $446 per hour) + (Compliance Attorney (20 hours) at $334 per hour)] = $101,740 per respondent × 850 respondents = $86,479,000. All hourly cost figures are based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2013 (modified by the SEC staff to account for an 1800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead).

[170] *See* 2015 Regulation SBSR Adopting Release, 80 FR at 14701 n. 1232. Specifically, the Commission estimated the burden of building an internal order and trade management system capable of capturing the relevant transaction information.

[171] This estimate is based on the following internal costs: [(Sr. Programmer (32 hours) at $303 per hour) + (Sr. Systems Analyst (32 hours) at $260 per hour) + (Compliance Manager (60 hours) at $283 per hour) + (Compliance Clerk (240 hours) at $64 per hour) + (Director of Compliance (24 hours) at $446 per hour) + (Compliance Attorney (48 hours) at $334 per hour)] = $77,092 per respondent × 850 respondents = $65,450,000.

[172] This estimate is based on the following internal: [($250/gigabyte of storage capacity) × (4 gigabytes of storage)] = $1,000 × 850 respondents = $850,000.

Commission used in connection with Regulation SBSR.[173] Also consistent with the calculation of the initial burdens, the Commission believes it appropriate to use the more conservative estimate in this proposing release (*i.e.,* without regard to the possibility of leveraging some parts of the Regulations SBSR transaction reporting systems) given that the Commission has not previously proposed or adopted position reporting requirements with respect to security-based swaps.

Finally, the collection of information includes the filings required to be reported to the Commission pursuant to Rule 10B–1. The Commission believes that persons that exceed the reporting thresholds in proposed Rule 10B–1(b)(1) will submit an estimated 1,000 reports per week. This number is based on information in section VI.D.2.iii.(A) (Economic Analysis), which estimates that the Commission will receive approximately 362 reports related to Security-Based Swap Positions that are CDS from U.S. persons, and 291 reports related to Security-Based Swap Positions that are CDS from non-U.S. persons.[174] However, given that such range may be overestimating the number of reports on both ends of that spectrum, as discussed in section VI.D.2.iii.(A), the Commission believes it reasonable to use an aggregate number of approximately 500 reports per week.

In addition, because the Commission does not yet have the data necessary to make a similar estimate for security-based swaps based on equity securities or other debt securities, we are doubling the estimate provided for CDS positions, for a total of 1,000 reports per week. As explained in connection with estimating the number of respondents that will be required to submit reports pertaining to CDS positions, we believe that doubling the estimate related to CDS positions is reasonable given what we know about the composition of the security-based swap market.[175] Accordingly, the Commission believes that it will receive 52,000 reports annually.[176]

The Commission also estimates that each of those estimated 52,000 reports will take approximately 14.5 hours to complete. This number is consistent with the estimate used in the collection of information for Schedule 13D.[177] Although the Commission recognizes that proposed Rule 10B–1 and Regulation 13D–G differ in terms of both purpose and scope, we believe that the process of completing both forms would be similar. Accordingly, the Commission estimates that all respondents will incur an annual burden of 754,000 hours in the aggregate to complete these 52,000 reports on proposed Schedule 10B.

E. Collection of Information Is Mandatory

The collection of information for proposed Rule 10B–1 (including Schedule 10B) is a mandatory collection of information.

F. Confidentiality

Given the intended benefits of public reporting of the information required to be reported on Schedule 10B pursuant to proposed Rule 10B–1, as set forth in section I.C and reiterated in section V.B., responses made pursuant to this collection of information would not be confidential and would be publicly available.

G. Request for Comment

We request comment on whether our estimates are reasonable. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) determine whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology. Persons wishing to submit comments on the collection of information requirements of the proposed amendments should direct them to the OMB Desk Officer for the Securities and Exchange Commission, *MBX.OMB.OIRA.SEC_desk_officer@omb.eop.gov,* and should send a copy to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090, with reference to File No. S7–32–10. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release; therefore a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–32–10, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington, DC 20549–2736.

VI. Economic Analysis

A. Introduction

The Commission is mindful of the economic effects, including the costs and benefits, of re-proposed Rule 9j–1, proposed Rule 10B–1, and proposed Rule 15Fh–4(c). Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking pursuant to the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, also to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[178] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact the proposed rules would have on competition.[179] Section 23(a)(2) of the Exchange Act also provides that the Commission shall not adopt any rule that would impose a

[173] *See* 2015 Regulation SBSR Adopting Release, 80 FR at 14701 nn. 1235 and 1236.

[174] *See infra* note 252.

[175] *See supra* section V.C (explaining that because the Commission believes that single-name CDS contracts make up a majority of security-based swaps, we have decided to use a conservative approach by estimating that the an equal number of respondents would be required to file at least one report related to CDS positions as would be required to file at least one report related to Security-Based Swap Positions consisting of other types of security-based swaps. The same rationale applies with respect to the estimated number of reports that the Commission would expect those respondents to file with respect to Security-Based Swap Positions consisting of security-based swaps based on equity securities and other debt securities (non-CDS).

[176] This estimate is based on the following: [(1,000 reports/week) × (52 weeks)] = 52,000 reports. In addition, the Commission previously estimated that 800 respondents will be subject to at least one reporting requirement pursuant to proposed Rule 10B–1. *See supra* section V.C. This estimate results in an average of 65 reports per respondent.

[177] *See* Proposed Collection; Comment Request; Extension: Regulation 13D and Regulation 13G, Schedule 13D and Schedule 13G; SEC File No. 270–137, 85 FR 25503 (May 1, 2020). The Commission recognizes that the 14.5 hour estimate for Schedule 13D is subsequently broken down based on the proportion of hours that would be carried internally by each respondent (25%), such that the other 75% would be carried by outside counsel (which was then monetized for purposes of the estimated burden). Because the Commission does not yet know what proportion of proposed Schedule 10B filings would be prepared externally, these estimates all assume that the entire 14.5 hour burden would be carried as *internal* costs by each respondent.

[178] *See* 15 U.S.C. 78c(f).

[179] *See* 15 U.S.C. 78w(a)(2).

burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The analysis below addresses the likely economic effects of re-proposed Rule 9j–1, proposed Rule 10B–1, and proposed 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 of re-proposed Rule 9j–1, proposed Rule 10B–1, and proposed Rule 15Fh–4(c) discussed below are difficult to quantify. For example, the Commission cannot quantify the impact of litigation and litigation risk to counterparties and underlying entities or the overall impact to 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 behavior. Reputational and credibility effects also are difficult to measure. Therefore, while the Commission has attempted to quantify economic effects where possible, much of the discussion of the anticipated economic effects below is qualitative and descriptive in nature.

B. Broad Economic Considerations

Credit Default Swaps

The single-name CDS market is a specialized venue for the transfer of credit, or default, risk of individual companies. This type of security-based swap allows market participants to obtain (or unload) exposure to the credit risk of an issuer without having to purchase (or sell) the issuer's bonds; the de-coupling allows for more precise targeting of credit risk exposure levels and lower transaction costs.[180] Active participants in the CDS market tend to be (a) highly-informed investors, such as hedge funds, pension funds, endowments, etc., that have a directional view on the economic prospects of an issuer; and (b) participants who have some natural exposure to the credit risk they want to hedge, such as ownership of the issuer's bonds or counterparty exposure to the issuer.[181] The latter category tends to include, for example, insurance companies, fixed-income investment funds, and broker-dealers. In general terms, the CDS market has the characteristics of a zero-sum game, where losses by one party to a transaction are offset by gains by the other party. The market provides incentives for participants to compete by leveraging marginal informational advantages, thereby forming information asymmetries among participants.

One example of material information that could lead to such an asymmetry is the trading characteristics of the issuer's related instruments, including the number of contracts that a market participant holds on a specific bond issue. This data is important because some market participants in the past have engaged in tactics that academics and media have described as ''opportunistic strategies.'' [182] Opportunistic strategies usually leverage large positions relative to the overall credit market for a specific issuer and can take a number of different forms. However, as a general matter, these 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 defaults. The larger the directional position, the greater the economic motivation to enter into these types of trades. 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.[183] Currently there is limited, if any, public information about the size of security-based swap positions held by a counterparty, so the average CDS market participant, despite being sophisticated and well-informed, is often unaware of the risk of being on the losing side of an opportunistic strategy. Because market participants could incur heavier-than-expected losses if their counterparty employed such a strategy, they may be disincentivized to participate in the market. This type of scenario—where a party's need to anticipate a bad outcome in a future transaction without full information could disincentivize certain behavior—is referred to as ''adverse selection.''

Adverse selection has been thoroughly documented in the economic literature, and its deleterious effects on market participation and efficiency are well known in sectors such as banking,[184] insurance,[185] and used cars.[186] Though the Commission lacks data that would show the direct link between the current CDS market condition (and the degree of adverse selection) and participants' appetite to trade, ''opportunistic strategies'' (which are symptomatic of a market with adverse selection) increase inefficiency in the market. To the extent that market participants anticipate ''opportunistic strategies,'' the CDS spread or price becomes a reflection of the likelihood of a ''manufactured'' strategy being announced (or, if already announced, of succeeding) and decouples from the credit fundamentals of the reference entity. This effect reduces the utility of the 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.[187]

Furthermore, the adverse selection problem in the CDS market runs in both directions. In contrast to the used car market, where the seller nearly always has more information and therefore the buyer must preempt the possibility of buying a ''lemon,'' in the CDS markets both buyers and sellers have the potential to leverage their market positions and engage in ''opportunistic

[180] CDS prices primarily relate to the credit risk component of a bond, while bond prices reflect both credit risk and the risk free rate. Hence, to replicate the bond, the CDS market participant needs exposure to both the CDS and the risk free bond, which has an additional cost.

[181] Martin Oehmke & Adam Zawadowski, The Anatomy of the CDS Market, 30 The Rev. of Fin. Stud., (Jan. 2017), at 80, 80–119 (*available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2023108*).

[182] Researchers, using a sample period from the fourth quarter of 2010 to the second quarter of 2018, have argued that these types of strategies have likely increased over time. *See* Danis & Gamba, supra note 22 at Figure 1.

[183] 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.

[184] Joseph E. Stiglitz & Andrew Weiss, Credit Rationing in Markets with Imperfect Information, 71 The Am. Econ. Rev., at 393 (June 1981) (presenting a model showing that, in a world with imperfect information, the use of interest rates or collateral in the screening process can introduce adverse selection and reduce overall expected loan profitability).

[185] *See* Amy Finkelstein & James M. Poterba, Adverse Selection in Insurance Markets: Policyholder Evidence from the U.K. Annuity Market, Nat'l Bureau of Econ. Rsch. NBER Working Paper, Paper No. 8045 (Dec. 2000), (*available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=489682*).

[186] George A. Akerlof, The Market for 'Lemons': Quality Uncertainty and the Market Mechanism, 84 Q. J. of Econ., at 488, 488–500 (Aug. 1970) (discussing a single-sided market for used cars where the seller is more informed then the buyer, leading to asymmetric information and potential market failure).

[187] *See* Fletcher, *supra* note 21 (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).

strategies,'' to the detriment of their counterparties.

In addition to the market imperfection mentioned above, the resemblance of a CDS contract to an insurance policy on an asset may give rise to information asymmetries amongst its counterparties. Since buying a CDS contract offers insurance to bondholders in the case of default, bondholders who buy CDS (pay a periodic premium) are less concerned about the health of the cash flows of the underlying asset, and in general less likely to renegotiate the terms in a bond contract.[188] This divergence in the expected outcomes of a transaction *after* a transaction occurs is called ''moral hazard'' or, specific to the CDS market, an ''empty creditor.'' [189] In this particular scenario, CDS sellers would likely prefer not to transact with such CDS buyers or could have trouble pricing this risk, to the extent they are unaware of which counterparty is such an empty creditor.[190] Additional information for market participants in the form of reporting, however, may also alleviate part of this information asymmetry [191] by making it easier for CDS sellers to identify such counterparties, thus mitigating the potential for moral hazard.

Total Return Swaps

The total return swap (TRS) [192] market differs from the CDS market in that the counterparties in a TRS take on the price and dividend risk of a reference stock and not the risk of default. Counterparties in the TRS market use the contracts to obtain exposure, usually leveraged, to the price movement and dividend payments of a stock or index and benefit from not having to own the stock itself. Market participants, such as mutual funds, hedge funds, and endowments, use TRS to obtain exposure in markets where they would face difficulties [193] purchasing or selling the underlying stock while taking advantage of the capital efficiencies of not holding shares in their inventories.

The risks attendant to the accumulation of large positions in TRS are different from CDS: With TRS, the main risk is that highly leveraged positions are very sensitive to price fluctuations of the underlying asset. The larger the position, the higher the risk that drastic price fluctuations may impair the solvency of the investor and, as a result, may create default risk for the security-based swap counterparty.

As in the CDS market,[194] the lack of public information about market positions means that market participants may not be aware of the risk of default of their counterparties, especially to those with concentrated, large positons who would be more prone to risks from price fluctuations. While counterparties could attempt to price in the risk of additional default risk, they currently lack the information necessary to accurately calculate the magnitude of that additional risk.

The existence of this information asymmetry that ensues from the party attaining the large position may create an economic externality. This externality is one where a market participant who decides to take on a large leveraged position in the underlying entity through a TRS will not internalize the total societal cost of a negative outcome where it declares bankruptcy. When the market participant amassing the large position fails, the costs of the participant's behavior on the issuer of the security, its counterparty, and the reputation of the market could be larger than those internalized by the failing party. Reporting could alleviate the externality by making information public that could be incorporated into TRS prices, thus requiring the party with the equity exposure to fully pay for the additional risks that it is incurring. Counterparties that have amassed large economic exposures in a specific security or TRS on that security (or both) and are therefore at greater risk of default could then be more easily identified.

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 SBS market are currently subject to the general antifraud and anti-manipulation provisions of the Federal securities laws, including Sections 9(a), 10(b) and Rule 10b–5 under the Exchange Act, and Section 17(a) of the Securities Act. 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 requires the Commission to adopt rules to prevent fraud, manipulation, and deception in connection with security-based swaps.[195]

In addition, 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; rules relating to capital, margin, and segregation requirements for SBSDs, MSBSPs, and broker-dealers (the ''Capital, Margin, and Segregation Rules''); [196] and rules relating to recordkeeping and reporting requirements for SBSDs, MSBSPs, and broker-dealers (the ''Recordkeeping Rules'').[197] The Risk Mitigation Rules, which consist of 17 CFR 240.15Fi–3 (''Rule 15Fi–3''), 17 CFR 240.15Fi–4 (''Rule 15Fi–4''), and Rule 15Fi–5, relate to, other things, reconciling outstanding security-based swaps with applicable counterparties on a periodic basis, engaging in certain forms of portfolio compression exercises, as appropriate, and executing written security-based swap trading relationship documentation with each of its counterparties prior to, or contemporaneously with, executing a security-based swap transaction. When the Commission adopted those rules in December 2019, we explained that they were intended to play an important role in addressing risks to an SBS Entity as a whole, including risks related to the

[188] Bolton & Oehmke, *supra* note 112 at 2617, 2617–2655; *see also* András Danis, Do Empty Creditors Matter? Evidence from Distressed Exchange Offers, 63 Mgmt Sci., at 1271, 1271–1656 (Oct. 2015) (*available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2001467*).

[189] Bengt Holmström, Moral Hazard and Observability, 10 The Bell J. of Econ., at 74, 74–91 (Spring, 1979).

[190] There is evidence that even sophisticated market participants were unable to ex-ante price events characterized as ''empty creditor'' scenarios. *See Solus Alternative Asset Management LP* v. *GSO Capital Partners L.P.,* No. 18 CV 232–LTS–BCM (SDNY Jan. 29, 2018).

[191] The additional reporting could inform the market of the filer's interest in the underlying entity's solvency by allowing the observance of a conventional, hedging CDS position. For example, a CDS participant with a large long CDS position may be less interested in the underlying entity's solvency as compared to the issuing entity itself or to a bond investor without CDS insurance. Further, to the extent that a counterparty has not reported pursuant to the proposed rule, a market participant could infer information about a potentially lower level of risk associated with transacting with that counterparty.

[192] TRS include non-CDS debt-based security swaps, equity-based security swaps, and mixed swaps.

[193] A market participant may find it difficult to buy stock of a foreign company, or may have trouble locating a stock to sell short.

[194] Navneet Arora, Priyank Gandhi & Francis A. Longstaff, Counterparty Credit Risk and the Credit Default Swap Market, 103 J. of Fin. Econ., at 280, 280–293 (March 1, 2011) (*available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1830321*) (arguing that, ''[they] find that counterparty credit risk is priced in the CDS market.'').

[195] *See supra* note 5 and accompanying text.

[196] *See* Capital, Margin, and Segregation Adopting Release, 84 FR 43872.

[197] *See* Recordkeeping and Reporting Adopting Release, 84 FR 68550.

entity's safety and soundness.[198] For example, portfolio reconciliation is designed to allow SBS Entities to manage their internal risks by better ensuring agreement with their counterparties with respect to the material terms and valuation of each transaction (and thereby avoiding complications at various points throughout the life of the transaction).[199] Further, requiring an SBS Entity to document the terms of the trading relationship with each of its counterparties before executing a new security-based swap transaction should promote sound collateral and risk management practices by enhancing transparency and legal certainty regarding each party's rights and obligations under the transaction.[200] Similarly, portfolio compression, by allowing an SBS Entity to potentially eliminate offsetting and redundant uncleared derivatives transactions—as measured both by the number of contracts and the total notional value—reduces its gross exposure to its direct counterparties, including by eliminating all exposure (and credit risk) to certain counterparties.[201]

The Capital, Margin, and Segregation Rules, among other things: (1) Established minimum capital requirements for non-bank SBSDs and MSBSPs (*i.e.,* SBSDs and MSBSPs for which there is not a prudential regulator); (2) increased the minimum tentative net capital and net capital requirements for broker-dealers that use internal models to compute net capital; (3) established capital requirements tailored to security-based swaps and swaps for broker-dealers that are not registered as an SBSD or MSBSP to the extent they trade these instruments; and (4) established margin requirements for non-bank SBSDs and MSBSPs with respect to non-cleared security-based swaps.[202] That rulemaking also established segregation requirements for SBSDs and notification requirements with respect to segregation for SBSDs and MSBSPs.[203]

When the Commission adopted the Capital, Margin, and Segregation Rules, we explained that the capital requirements were designed to ensure that non-bank SBSDs and stand-alone broker-dealers, respectively, have sufficient liquidity to meet all unsubordinated obligations to customers and counterparties and, consequently, if the non-bank SBSD or stand-alone broker-dealer fails, sufficient resources to wind-down in an orderly manner without the need for a formal proceeding.[204] Similarly, in the course of discussing the margin requirements, the Commission explained that ''[i]n the market for non-cleared security-based swaps and in the market for OTC derivatives generally, collateral is the means for mitigating counterparty credit risk.'' [205] Finally, the Commission explained that segregation requirements were designed ''to protect the rights of security-based swap customers and their ability to promptly obtain their property from an SBSD or stand-alone broker-dealer.'' [206]

The Commission's Recordkeeping Rules also play an important role in reducing certain types of risk. Among other things, those rules, which also were adopted in 2019, establish recordkeeping, reporting, and notification requirements for SBSDs and MSBSPs and securities count requirements for stand-alone SBSDs, and also establish additional recordkeeping requirements applicable to stand-alone broker-dealers to the extent they engage in security-based swap or swap activities.[207] Many of those rules have been designed expressly to ''promote compliance with the financial responsibility requirements for broker-dealers, SBSDs, and MSBSPs, facilitate regulators' oversight and examinations of such firms, and promote transparency of their financial condition and operation.'' [208]

Market participants are already subject to the requirements of Regulation SBSR, which governs regulatory reporting of security-based swap transactions to SBSDRs. Regulation SBSR provides for real-time public reporting of individual security-based swap transactions to a SBSDR within 24 hours of the trade execution and the immediate public dissemination by the SBSDR of security-based swap transaction information, including pricing and volume information. Regulation SBSR requires certain items to be reported about each security-based swap transaction, such as the ''product ID'' [209]; date and time of the transaction; price and amount of up-front payments; notional amount; indication of whether the transaction will be submitted to clearing; and identification of the parties to the transaction. On November 8, 2021, mandatory reporting of new security-based swap transactions to SBSDRs began, with public dissemination of those transactions set to begin on February 14, 2022.[210] As of November 9, 2021, there are currently two registered SDRs: DTCC Data Repository (''DDR'') and ICE Trade Vault (''ITV''). As discussed above, any position reporting pursuant to Regulation SBSR is completely anonymous, and would therefore not inform participants that a specific counterparty was building up large, concentrated security-based swap positions.[211]

In addition, section 30(b) and 17 CFR 270.30b1–9 (''Rule 30b1–9'') of the Investment Company Act of 1940 require that registered investment companies and certain exchange-traded funds report information quarterly about their portfolios and each of their portfolio holdings, including security-based swaps, as of the last business day, or last calendar day, of each month. With the exception of certain non-public information, the information reported on Form N–PORT for the third month of each fund's fiscal quarter is made publicly available.

Finally, Rule 15Fk–1 requires an SBS Entity to designate a CCO and imposes certain duties and responsibilities on that CCO.[212] Further, existing rules require that a majority of the board approve the compensation and removal of the CCO.[213] Rule 15Fh–4(a) makes it unlawful for an SBS Entity to: (i) Employ any device, scheme, or artifice to defraud any special entity or prospective customer who is a special entity; (ii) engage in any transaction, practice, or course of business that operates as a fraud or deceit on any special entity or prospective customer

[198] *See* Risk Mitigation Adopting Release, 85 FR at 6378–79.

[199] *See* Risk Mitigation Adopting Release, 85 FR at 6361.

[200] *See id.* Both of the portfolio reconciliation and documentation requirements should also help to reduce counterparty credit risk and promote certainty regarding the agreed upon valuation and other material terms of a security-based swap. *See id.*

[201] *See id.*

[202] *See* Capital, Margin, and Segregation Adopting Release, 84 FR at 43874.

[203] *See id.*

[204] *See* Capital, Margin, and Segregation Adopting Release, 84 FR at 43959.

[205] *See* Capital, Margin, and Segregation Adopting Release, 84 FR at 44012.

[206] *See* Capital, Margin, and Segregation Adopting Release, 84 FR at 43959.

[207] *See* Recordkeeping and Reporting Adopting Release, 84 FR at 68607.

[208] *See id.*

[209] The term ''product ID'' is defined in Regulation SBSR to mean the ''unique identification code'' assigned to a product. *See* 17 CFR 242.900(bb) (defining ''product ID'') and 900(qq) (defining ''unique identification code''). Pursuant to Rule 901(c)(1) of Regulation SBSR, if there is no product ID, the reporting party is required to report certain information about the security-based swap, including, among other things, the asset class of the security-based swap, the specific underlying security, effective date, termination date, and certain payment terms.

[210] *See* 17 CFR 242.901(c).

[211] *See supra* note 5 and accompanying text.

[212] *See* 17 CFR 240.15Fk–1.

[213] *See supra* section II.D.

who is a special entity; or (iii) to engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative. 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.[214] In addition, the Commission's Risk Mitigation Rules are designed to foster effective risk management by requiring the existence of sound documentation, periodic reconciliation of portfolios, rigorously tested valuation methodologies, and sound collateralization practices.[215] Attempts by officers, directors or employees to hide transactions, submit false valuations or manipulate or fraudulently influence CCOs in the performance of their duties related to the Risk Mitigation Rules would undermine the SBS Entity's risk management.[216]

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

As of November 9, 2021, there are 41 entities registered with the Commission as SBSDs, and no entities have registered as MSBSPs. According to data published by the Bank for International Settlements (''BIS''), as of December 2020, there was approximately: (i) $3.5 trillion [217] in global notional amount outstanding of single-name CDS; (ii) $4.5 trillion in multi-name index CDS outstanding; and (iii) $347 billion in multi-name, non-index CDS outstanding.[218] The total gross market value outstanding in single-name CDS was approximately $77 billion, and in multi-name CDS instruments, there was approximately $125 billion outstanding. The global notional amount outstanding in equity forwards and swaps was $3.6 trillion, with total gross market value of $321 billion.[219]

The above-described data is provided on an aggregate and global basis. The Commission's primary source for disaggregated transactions and positions in the market for security-based swaps is the DTCC Derivatives Repository Limited Trade Information Warehouse (''DTCC–TIW''). 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 2020.[220] The Commission acknowledges that limitations in the data constrain the extent to which it is possible to quantitatively characterize the security-based swap market.[221] Based on an analysis of DTCC–TIW data, staff concluded that there are 2,321 transacting agents that engaged directly in trading between November 2006 and December 2020 with 15,187 accounts.[222]

Data from the DTCC–TIW show that activity in the single-name CDS market is concentrated among a relatively small number of entities, predominantly ISDA-recognized dealers and large banks, who act as dealers in this market.[223] The top five dealers (when accounts are sorted by number of counterparties) when combined transact with over a thousand counterparty accounts, consisting of both other dealers and non-dealers. The next 23% of dealers transacted with 500 to 1,000 counterparty accounts; 38% transacted with 100 to 500 unique accounts; and 31% of dealer accounts intermediated security-based swaps with fewer than 100 unique counterparties accounts in 2020. The median number of counterparty accounts across dealers is 276 (the mean is approximately 570). Dealer-intermediated transactions reached a gross notional amount of approximately $1.99 trillion, approximately 55% of which was intermediated by the top five dealer accounts. The median non-dealer counterparty transacted with only two dealer accounts (with an average of approximately 2.5 dealer accounts) in 2020.

Non-dealer single-name CDS market participants include, but are not limited

[214] *See* 17 CFR 240.15Fh–3(h).

[215] *See* Risk Mitigation Adopting Release, 85 FR 6359.

[216] *See supra* section II.D.

[217] The global notional amount outstanding represents the total face amount used to calculate payments under outstanding contracts. The gross market value is the cost of replacing all open contracts at current market prices.

[218] *See* BIS, Semi-annual OTC derivatives statistics at December 2020, Table D5.2, (*available at: https://stats.bis.org/statx/srs/table/d5.2* (accessed Aug. 18, 2021).

[219] These totals include swaps and security-based swaps, as well as products that are excluded from the definition of ''swap,'' such as certain equity forwards. *See* OTC, equity-linked derivatives statistics, Table D5.1, *available at https://stats.bis.org/statx/srs/table/d5.1* (accessed Aug. 18, 2021). For the purposes of this analysis, the Commission assumes that multi-name index CDS are not narrow-based index CDS and therefore, do not fall within the 'security-based swap' definition. *See* 15 U.S.C. 78c(a)(68)(A); *see also* Products Release, 77 FR 48208. The Commission also assumes that all instruments reported as equity forwards and swaps are security-based swaps, potentially resulting in underestimation of the proportion of the security-based swap market represented by single-name CDS. Therefore, when measured on the basis of gross notional outstanding single-name CDS contracts appear to constitute roughly 49% of the security-based swap market. Although the BIS data reflect the global OTC derivatives market, and not just the U.S. market, the Commission has no reason to believe that these percentages differ significantly in the U.S. market. Note that these data do not include TRS on debt which are covered by the proposal.

[220] DTCC Derivatives Repository Limited Trade Information Warehouse 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 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. Data do not address two foreign counterparties with CDS referencing foreign underlying entities. In addition, the DTCC–TIW data does 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.

[221] While the Commission has limited data regarding the activity of market participants in equity swaps, the Commission believes that the market for security-based swaps is sufficiently representative of the market. DTCC Derivatives Repository Limited Trade Information Warehouse 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 U.S. entity, with status as a U.S. entity determined by DTCC–TIW. 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.

[222] These 2,321 entities, which are presented in more detail in Table 1, 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 December 2017. 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.,* Dealing Activity Adopting Release, 81 FR 8602, n.43. 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). One entity or legal person (known as ''transacting agent'' in the terminology of 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.

[223] 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). Security-based swap dealers 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 engages 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.

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 parties, consistent with DTCC–TIW terminology.[224] As shown in Table 1, close to 78 percent of transacting parties are identified as investment advisers or funds, of which approximately 40 percent (about 32 percent of all transacting parties) are registered as investment advisers under the Advisers Act.[225] Although investment advisers and funds are the vast majority of transacting parties, the transactions they executed account for only 9.5 percent of all single-name CDS trading activity reported to the DTCC–TIW, measured by the number of transaction sides.[226] The vast majority of transactions, 82.1 percent, measured by number of transaction-sides were executed by ISDA-recognized dealers.

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Table 1. The number of transacting parties by counterparty type and the fraction of total trading activity, from November 2006 through December 2020, represented by each counterparty type.

	Total Number of transacting parties	Percent	Total Transaction Share	Number of US Firms	Percent	US Transaction Share
Investment Advisers/Funds [a]	1,823	78.5%	14.2%	1,052	91.8%	18.5%
- *SEC registered (IA)*	*734*	*31.6%*	*9.5%*	*619*	*54.0%*	*13.3%*
- *Mutual funds and ETFs*	*411*	*17%*	*6%*	*334*	*29%*	*5%*
Banks (excluding G16)[b]	274	11.8%	3.3%	13	1.1%	0.0%
Pension Funds	30	1.3%	0.1%	2	0.2%	0.0%
Insurance Companies	48	2.1%	0.2%	30	2.6%	0.3%
ISDA - Recognized Dealer[c]	17	0.7%	82.1%	7	0.6%	81.2%
others	129	5.6%	0.2%	42	3.7%	0.1%
Total	2,321	100.0%	100%	1,146	100.0%	100%

[a] Investment Adviser/Funds – For purposes of this table, these entities have the following characteristics: clients are predominantly individuals, institutions, investment companies, pensions and profit sharing, registered investment companies, pensions and 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 on its own account and not just on behalf of its clients. This includes depository institutions, swaps dealers (market makers), and classically-defined investment banks.

[c] ISDA recognized dealer – market maker (dealers) identified by ISDA as belonging to the G14 or G16 dealer group during the period. See, e.g., https://www.isda.org/a/5eiDE/isda-operations-survey-2010.pdf.

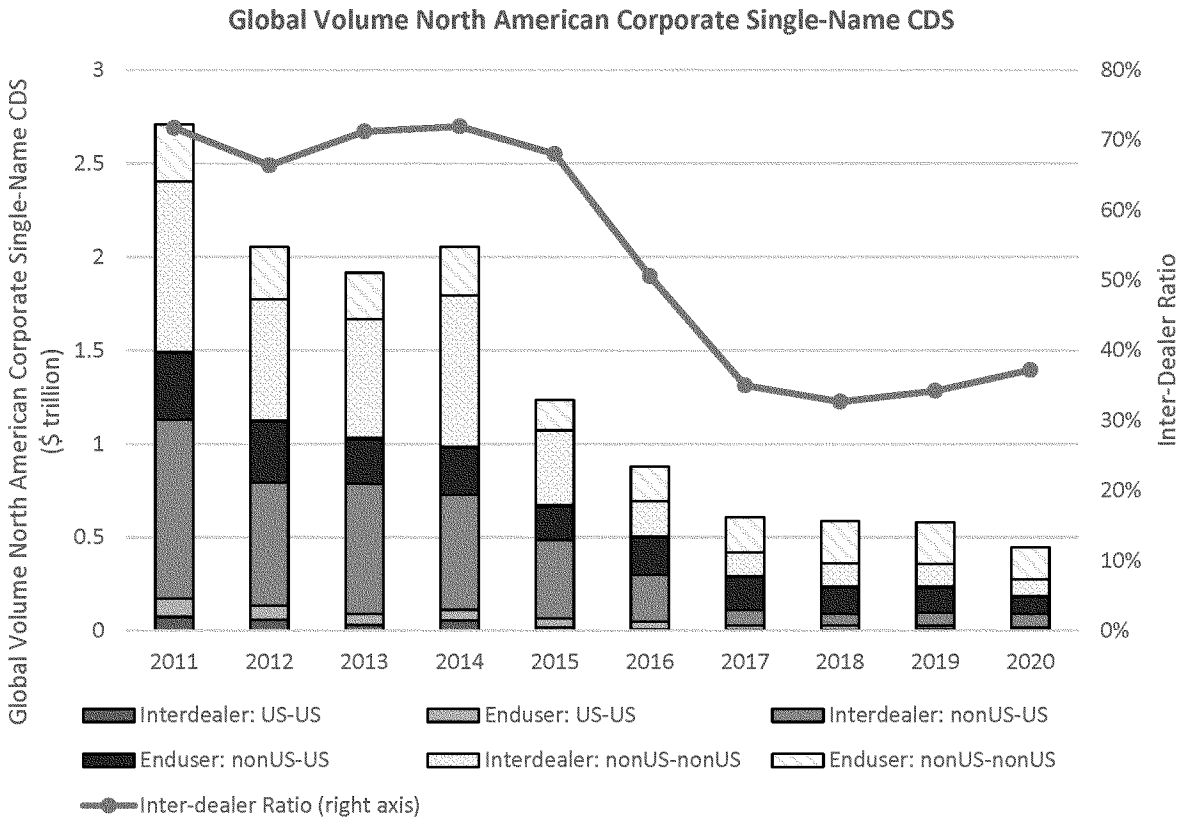
Figure 1 describes the percentage of global, notional transaction volume in North American corporate single-name CDS reported to the DTCC–TIW from January 2011 through December 2020, separated by whether transactions are between two ISDA-recognized dealers (interdealer transactions) or whether a transaction has at least one non-dealer counterparty. As proposed Rule 10B–1 would affect U.S. market participants as well as foreign entities who trade in both the security-based swap and underlying asset, Figure 1 compares the notional trading volume of all North American corporate single-name CDS to notional trading of U.S. counterparties. The observed declining trend seems to impact proportionally all types of exposures. As Figure 1 shows, all types of exposures have declined approximately proportionally since 2011.

[224] *See* 15 U.S.C. 80b1 through 80b21. Transacting parties 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 party.

[225] DTCC-defined ''firms'' shown in DTCC–TIW, which we refer to here as ''transacting parties.''

[226] Each transaction has two transaction sides, *i.e.,* two transaction counterparties.

Figure 1: Global, notional trading volume in North American corporate single-name CDS by calendar year and the fraction of volume that is inter-dealer.[a]



[a] Same-day cleared trades are assumed to be either inter-dealer or between a dealer and an end-user (as security-based swap transactions between two end-users are rare in both the cleared and un-cleared markets).

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As mentioned above, DTCC–TIW data covers only CDS positions. However, the Commission staff has access to some information on affected parties using filings from Form N–PORT. As discussed above, certain registered investment companies must report information quarterly about their portfolios to the Commission in Form N–PORT. DTCC–TIW data is summarized in Table 1, indicate that in the CDS market, mutual funds and Exchange Traded Funds (ETFs) that report on Form N–PORT represent approximately 17% of firms in DTCC–TIW, and make up approximately 6% of all transactions available in DTCC–TIW.[227] As a percentage of US-only firms, mutual funds and ETFs that report on Form N–PORT represent approximately 29% of firms in the U.S. and approximately 5% of total U.S. transactions reported in DTCC–TIW. These transactions provide a sample of the entities participating in the CDS market that are mutual funds and ETFs, which are required to file Form N–PORT.[228]

D. Consideration of Costs and Benefits; Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

1. *Re-proposed Rule 9j–1 and Proposed Rule 15Fh–4(c)*

i. *Benefits*

The Commission believes that re-proposed Rule 9j–1 would decrease fraudulent activity, affect compliance costs, and lower litigation costs. In addition, re-proposed 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.

The Commission believes that re-proposed Rule 9j–1 would reduce the risk of fraud in the security-based swap market, including risk of fraudulent behavior undertaken in connection with opportunistic trading strategies. The additional specificity offered by re-proposed 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. Further, by reducing these risks, re-proposed Rule 9j–1 could encourage participation in the market, which may result in increased competition.[229] More security-based swap entities would be willing to supply (issue) and/or demand (buy) security-based swaps, with increased confidence that their

[227] The analysis in Table 1 using DTCC–TIW data is performed on transacting party level, while analysis of Form N–PORT data is performed at fund level. Due to data limitations and no direct linkages between DTCC–TIW and N–PORT data, the Commission cannot directly compare entities reporting to DTCC–TIW to entities that file Form N–PORT.

[228] Form N–PORT is to be used by a registered management investment company, or an exchange-traded fund organized as a unit investment trust, or series thereof (''Fund''), other than a Fund that is regulated as a money market fund (''money market fund'') under 17 CFR 270.2a–7 (''Rule 2a–7'') under the Investment Company Act of 1940, 15 U.S.C. 80a (''Act'') or a small business investment company (''SBIC'') registered on Form N–5 (17 CFR 239.24 and 274.5), to file reports of monthly portfolio holdings pursuant to Rule 30b1–9 under the Act (17 CFR 270.30b1–9).

[229] *See* Joint Statement, *supra* note 29.

counterparties would have limited abilities to impact the market using, among other things, opportunistic strategies.

The Commission also believes that, by providing additional precision and specificity regarding the application of existing antifraud and anti-manipulation laws to misconduct in the security-based swap market, re-proposed Rule 9j–1 could prompt some market participants to devote greater resources to ensure that they are compliant with their obligations under antifraud and anti-manipulation law, 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. Conversely, by providing additional precision and specificity regarding the application of existing antifraud and anti-manipulation provisions of the Federal securities laws to misconduct in the security-based swap market, the re-proposed Rule 9j–1 could 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, including risk of fraudulent behavior undertaken in connection with opportunistic trading strategies, in the security-based swap market may also lead to increased price efficiency, as new trading could lead to a greater exchange of market expectations from buyers and sellers transacting in the market. 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. For example, 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 an ''opportunistic'' or ''manufactured credit'' strategy were successful.[230] Further, by providing specificity, re-proposed Rule 9j–1 would help prevent prohibited conduct from distorting the market and artificially increasing or decreasing prices for security-based swaps. Thus, we believe the proposed rules would help to ensure more efficient pricing.

In addition, the Commission expects the price efficiency in the underlying securities markets to 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 debt and equity capital costs for security-based swaps referenced entities. For example, if prices of single-name CDS are more reflective of 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 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.[231] Greater activity in the underlying security market due to 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.

Proposed Rule 15Fh–4(c) would make 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, 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. We expect that this rule change would make it more likely that a CCO would be 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 security-based swap entity. Ultimately, we expect that these effects would 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.

Proposed Rule 15Fh–4(c) would likely have minor indirect positive impacts on price efficiency, competition, and capital formation. 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 be more likely to be reflective of the fundamental credit risk of the underlying entity, positively influencing price efficiency and competition among market participants. 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, in turn, lower costs of borrowing (as a result of cheaper CDS).

ii. Costs

Some security-based swap market participants may incur costs associated taking actions to update existing compliance systems for compliance with re-proposed Rule 9(j)–1. We expect, however, that these additional costs would be relatively small because 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.[232]

In addition, the proposed 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

[230] *See* Fletcher, *supra* note 21.

[231] *See* Haibin Zhu, An Empirical Comparison of Credit Spreads between the Bond Market and the Credit Default Swap Market, EFMA 2004 Basel Meetings Paper, BIS Working Paper No. 160, (Aug. 2004) (*available at: https://ssrn.com/abstract=477501*); *see also* Jongsub Lee, Andy Naranjo, and Guner Velioglu, When do CDS Spreads Lead? Rating Events, Private Entities, and Firm-specific Information Flows, 13 J. of Fin. Econ., 556, at 556–578 (2017) (*available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2933052*) (addressing the size of US single-name reference entities).

[232] As noted above, some commenters to the 2010 proposed rule argued that not requiring scienter with respect to paragraphs (3) and (4) of re-proposed Rule 9j–1(a) (which were paragraphs (c) and (d) in the 2010 proposed rule) ''could potentially deter many parties from entering into SBS, increase their cost and have other distorting effects on the markets.'' Because Rule 9j–1(a), as discussed above, does not apply a new scienter standard to market conduct, we do not expect such increases in costs or distorting effects on the market. *See supra* section II.B.1.

certain activities are permissible may increase for some market participants. However, because re-proposed Rule 9j–1 would provide additional precision and specificity regarding the application of existing antifraud and anti-manipulation laws to misconduct in the security-based swap market, the Commission believes that these costs would not be significant. Further, these costs would be mitigated to the extent that the limited safe harbor from certain provisions of re-proposed Rule 9(j)–1 addresses situations in which a counterparty is required to take certain pre-agreed actions with respect to the security-based swap, or to effect certain transactions related to portfolio compression exercises, in each case while in possession of material non-public information.

Proposed 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 may include activities that would be explicitly prohibited under Rule 15Fh–4(c), applicable policies and procedures would need to be updated. In addition, it is possible that the proposed rule could cause SBS Entity employees to be overly cautious when consulting with a CCO. We do not, however, believe that any such effects will be significant, given the specificity of the rule's prohibition on certain interference with the SBS Entity's CCO.

2. Proposed Rule 10B–1

i. Benefits

Proposed Rule 10B–1 could increase market integrity, increase liquidity, decrease counterparty risk, lower litigation costs, decrease cost of capital for underlying entities, decrease contagion risk in the market, and assist the Commission in identifying concentrated position and holdings in related securities. We discuss each of these benefits below.

The Commission expects proposed Rule 10B–1 reporting requirements to enhance the integrity of the security-based swap market. The proposed reporting requirements would inform market participants of large concentrated positions that might give the holder incentives to affect the timing or the payoff size of the CDS contract for the CDS buyer's benefit. As a result, market participants would be better able to assess counterparty risk. In this respect, the Commission recognizes that the Risk Mitigation Rules; Capital, Margin, and Segregation Rules; and Recordkeeping Rules may address similar risks, to the extent that these rules are intended to, among other things, promote safety and soundness of SBS Entities, enhance the transparency of obligations under transactions with SBS Entities, protect the ability of security-based swap customers to promptly obtain their property, and promote compliance with financial responsibility requirements for broker-dealers, SBSDs, and MSBSPs. However, because of proposed Rule 10B–1's application to non-SBS Entities, in addition to SBS Entities, and the proposed rule's reporting-based method to the reduction of counterparty risk, the proposed rule would afford additional protections to market participants, including with respect to large position concentration risk. In contrast to the Risk Mitigation Rules; Capital, Margin, and Segregation Rules; and Recordkeeping Rules, proposed Rule 10B–1 would provide information to market participants for them to take specific mitigating actions to limit counterparty risk exposure.

Further, to the extent that market participants are better able to assess counterparty risk as a result of the reporting that would be required under proposed Rule 10B–1, it would likely become more expensive to build such positions, because market participants may refrain from trading with a reporting counterparty, trade only at prices that account for additional risk, or ask for larger margin postings of collateral. These actions would likely make it unprofitable to create market conditions that would impact the timing or the size payoff of the CDS contract. Further, because the reporting required under proposed Rule 10B–1 would inform the Commission of material, directional positions, it may enhance Commission oversight of the security-based swap market, which may ultimately benefit market participants. In particular, it would provide the Commission tools to monitor for large concentrated positions, counterparty risk, and potentially detect fraudulent behavior, as the Commission would have access and complete visibility to both the security-based swap and the related underlying asset for participants that would be required to report.

Because proposed Rule 10B–1 would make it more challenging to create market conditions that would affect the timing or the size payoff of the CDS contract, proposed Rule 10B–1 would likely result in greater overall market integrity. Through better information for market participants, the Commission expects proposed Rule 10B–1 to encourage participants to increase capital buffers (*i.e.,* both initial and variation margins) where needed and help to prevent the impact of defaults from spreading through exposed counterparties, thereby limiting ''contagion risk'' (*i.e.,* risk that might result from indirect counterparty risk) in the market.

Further, by requiring large CDS buyers to report their positions, proposed Rule 10B–1 may help reduce the presence of moral hazard in single-name CDS markets. As described in the Broad Economic Considerations, in the presence of asymmetric information, bondholders who are also CDS buyers may become disinterested in the solvency of the underlying asset, and may become less inclined to renegotiate contracts in order to avoid a default in bond payments. Proposed Rule 10B–1 would benefit market participants by requiring reporting of large CDS positions and allowing market participants to identify counterparty risk, adjust prices for counterparty risk, and limit the scope of moral hazard.

Such increases in market integrity may allow market participants to trade with more and with greater confidence in the market. As a result, proposed Rule 10B–1 could lead to increased supply and demand for security-based swaps, leading to greater competition as more security-based swap market participants enter the market. Further, this would consequently lead to greater security-based swap market efficiency, as security-based swap prices would more likely reflect fundamental values and risk in more liquid markets. For example, prices of single-name CDS contracts would more likely reflect the fundamental credit risk of the underlying entity. Thus, we expect the proposed rules would help to ensure more efficient pricing in the security-based swap market. Price efficiency would increase, as participants would be better informed of likely outcomes. Further, we expect that such increases in price efficiency in the underlying securities markets would have some positive impact on capital formation and capital costs for the underlying entities, similar to the effect described above for re-proposed Rule 9j–1. As security-based swap prices become more informative, more likely reflecting the fundamental risk of the underlying entity, more market activity could follow.

Because of both the decreased counterparty risk and greater market integrity, the proposed Rule 10B–1 reporting requirements may also lead to lower litigation costs between security-based swap participants. As discussed above, the proposed rule would likely

limit or constrain exposure buildup in the security-based swap market, making it less profitable to accumulate positions at sizes that might incentivize market participants to affect the timing or the size payoff of the CDS contract. Although those actions may not be fraudulent, manipulative, or deceptive, there are situations (which are discussed in section I.B) where the accumulation of a large CDS position could signify misconduct. To the extent that an increased risk of litigation is associated with such potentially manipulative or unexpected behavior, proposed Rule 10B–1 would make it more likely that market participants can avoid such costs.

With respect to the requirements to report certain information,[233] public reporting of certain identifying information would have the benefit of increasing market liquidity, as a result of the counterparties being able to identify the market participant who exceeded the reporting threshold and limit their counterparty risk exposure to them.[234] In that regard, the use of standard identifiers—namely, the product ID for the security-based swaps, the FIGI for securities (or any other unique security identifier(s) that may be included at the filer's option), and the LEI for legal entities—on Schedule 10B would augment transparency by providing consistent identification of entities and securities across datasets and jurisdictions, allowing market participants to cross-reference the data reported on Schedule 10B with data reported from any other sources that use those standard identifiers.[235] In turn, enhanced transparency would reduce transactional and operational costs of trading, making transactions cheaper and more frequent.

Requiring the reporting of the notional amount of the applicable security-based swap, and related securities with the same underlying asset would allow market participants to quantify the size of the position in the security-based swap, the underlying security, and related securities, meaning that participants would know the exact size of the concentrated position that led to the threshold being exceeded. The information required to be reported by proposed Rule 10B–1 complements what is required to be reported pursuant to Regulation SBSR, and because market participants would, as a result of the proposed rule, be aware of counterparty risks, proposed Rule 10B–1 may encourage more participation in the market, which would increase liquidity in the market for security-based swaps.

In addition, as a second order effect, the proposed Rule 10B–1 could have positive spillover benefits in markets of the specific underlying entity, *i.e.,* bond markets for CDS and bond swaps, or equity markets for TRS, respectively. Specifically, the increased liquidity in the security-based swap market could allow participants in capital markets to more easily hedge capital investments they make in underlying entity securities (*e.g.,* both bond and equities). To the extent that capital investments are more easily hedged, capital market participants may be more likely to participate in these markets and hence more likely to provide capital to the underlying entities.

As discussed above, the Commission has access to single-name CDS data through DTCC–TIW and a subsample of TRS data through Form N–PORT.[236] In addition, reporting of security-based swap transactions is now required.[237] The Commission's oversight of the security-based swap market would be enhanced by the proposed reporting requirement in the proposed Rule 10B regarding related securities, which are not reported through DTCC–TIW or security-based swap transaction reporting. Proposed Rule 10B–1 would give the Commission access to information that would allow it to better evaluate a reporting firm's security-based swap positions (and in many cases, information about other securities positions), thereby allowing the Commission to identify potential market misconduct (*e.g.,* insider trading or market manipulation), default and contagion risk related to large concentrated positions.

Reporting entities would be required to file Schedule 10B on EDGAR in a structured, machine-readable data language (specifically, FIXML). This would benefit market participants by improving the usability, accessibility, and reliability of the Schedule 10B reports. By requiring a machine-readable language and a centralized, publicly accessible filing location for Schedule 10B, the Commission would enable market participants to download the reported information directly into their databases and analyze the information using various tools and applications, thus augmenting the informational benefits that Rule 10B–1 would create. The requirement to use FIXML, an open standard maintained by a market standard setting organization, for the Schedule 10B reports would allow those market participants that already use FIXML for financial information exchange to leverage their existing systems and processes in preparing the reports (if applicable) and/or using the reports for analysis. Use of FIXML may also allow greater comparability of the data to that from other reports to the Commission. Furthermore, because the EDGAR system provides basic validation capabilities, the requirement to submit Schedule 10B on EDGAR would reduce the incidence of non-discretionary errors of Schedule 10B, thereby improving the quality of Schedule 10B reports.

Concerning timing, proposed Rule 10B–1 would require security-based swap entities to file promptly, but in no event later than the end of the first business day following the day of execution of the security-based swap transaction that results in the exposure exceeding the reporting threshold. The benefit of filing promptly would likely lead to increases in market and price efficiency as prices would reflect this information quickly. That is, counterparties would be able to react quickly if warranted to this additional information by adjusting their security-based swap, underlying security, or related security positions, or margin requirements.

ii. Costs

The Commission expects Rule 10B–1 to create reporting costs for counterparties that have large concentrated exposures that breach the reporting thresholds, and decrease liquidity or increase trading costs for

[233] *See* proposed Rule 10B–1(a) and Schedule 10B (providing a complete list of information required to be disclosed). Proposed Rule 10B–1 would require persons subject to the proposed rule to report, among other things: (1) Identifying information, including for example, the name of reporting party, the reporting party's LEI and the LEIs of the issuers of underlying and related securities (if available), place of organization, type of reporting person; and (2) the notional amount of the applicable related security-based swap, the underlying security's FIGI, and the FIGIs of related securities that share the same underlying asset.

[234] Having a reporting requirement with no identification might only partially solve the informational asymmetry problem described in the Basic Economic Considerations section. For example, if the report was designed to only disclose information about the security-based swap and underlying securities, but withheld information about the security-based swap participant, it would potentially lead to all market participants to believe their particular counterparty was the one that breached the threshold. The missing information would likely cause market participants to unnecessarily withdraw from the market, decreasing either supply or demand.

[235] Product IDs, if available, are a required element of security-based swap reporting obligations under Regulation SBSR. *See* 17 CFR 242.901(c)(1). Regulation SBSR reporting obligations do not require LEI or FIGI.

[236] *See supra* section VI.C.2 (describing security-based swap data).

[237] *See supra* section VI.C.1 (describing existing major regulatory reporting regimes for security-based swap market).

entities who have triggered reporting thresholds. As discussed above, to the extent that market participants are better able to assess counterparty risk as a result of the reporting that would be required under proposed Rule 10B–1, market participants may limit their security-based swap activity with counterparties who have triggered the proposed rule's reporting thresholds. A market participant may determine that a counterparty that has triggered the reporting thresholds is too risky to trade with, or may increase initial or variation margins. While we believe that, as discussed above, liquidity for the overall market would improve as a result of the proposed rule, we believe that this the rule could decrease liquidity for these particular market participants.

Proposed Rule 10B–1 would impose reporting costs on market participants who trigger the proposed rule's thresholds. The Commission estimates that the number of reports would generally be less than 136 reports per week for U.S. security-based swap participants in the single-name CDS market.[238] The Commission expects this number to represent an upper limit for reports, as it is possible that some CDS counterparties would refrain to some extent from acquiring exposures that would require reporting. Additionally, the Commission expects the number of reports related to TRS positions to be smaller than the number of reports related to CDS positions, although the Commission cannot yet estimate a precise number due to the data limitations discussed above.[239] Some market participants are already subject to the reporting obligations of Regulation SBSR or SDR or Section 30(b) and Rule 30b1–9 of the Investment Company Act of 1940, so these entities may have already made previous relevant expenditures to build a technology system for reporting. Nonetheless, the monitoring of positions and, to the extent thresholds are triggered, public reporting of positions represents an additional reporting expense for all market participants, some of whom may not be familiar with reporting to the Commission.

As discussed above, up to 850 respondents will likely need to develop a technological infrastructure to calculate and monitor their security-based swap positions, even if some of those entities do not have at least one Security-Based Swap Position that is required to be reported pursuant to proposed Rule 10B–1(a).[240] We estimate that each respondent will incur a one-time initial cost of approximately $101,740 to develop such technological infrastructure, or $86,479,000 in the aggregate for all 850 respondents. In addition to developing the technological infrastructure to calculate and monitor their Security-Based Swap Positions in order to comply with the requirements of proposed Rule 10B–1, each respondent will be required to maintain and operate such system on an ongoing basis. The Commission estimates such annual costs will be $77,000 per respondent, or $65,450,000 in the aggregate for all 850 respondents. In addition to maintaining and operating such technological infrastructure, the Commission also believes that each respondent will incur a $1,000 annual cost to store such security-based swap position data, or $850,000 in the aggregate for all 850 respondents.

In addition, to the extent that market participants are better able to assess counterparty risk as a result of the reporting that would be required under proposed Rule 10B–1, market participants may limit their security-based swap activity with counterparties who have triggered the proposed rules' reporting thresholds. Where a counterparty has triggered reporting thresholds, the market participant may determine that the party is too risky to trade with, or may increase initial or variation margins. Under these circumstances, market participants may not trade with a reporting counterparty, trade only at prices that account for additional risk, or ask for larger margin postings of collateral.

As discussed above, proposed Rule 10B–1 would require persons subject to the proposed rule to report, among other things, identifying information, the notional amount of the applicable security-based swap (and in the case of equity-based security-based swaps, the percentage of shares represented by the security-based swap as a percentage of the outstanding number of shares), and related securities. The requirement to report information that identifies the market participant, for example the LEI, would allow market participants to identify the security-based swap participant that breached the threshold. With respect to the LEI requirement in particular, the Commission does not expect the requirement would impose compliance costs on reporting persons, because reporting persons would only have to provide LEIs only if they possess one at the time of submitting the report, and thus would not have to incur the cost to obtain and renew an LEI for the purpose of filing Schedule 10B.[241]

Other components of the reporting requirements would be costly to market participants because these reports could make their trading strategies public (by virtue of disclosing the size of their position), potentially causing their strategy to be less profitable in the future. For example, this information might lead other parties to replicate and use the reporting party's trading strategy for their own purpose. However, the information provided would be limited to only security-based swaps and related securities, and would not include information about the reporting parties' entire portfolios.

The requirement to file Schedule 10B reports on EDGAR would impose upon those reporting parties without prior access to EDGAR a one-time compliance burden of submitting a Form ID as required by Rule 10(b) of Regulation S–T and following the processes detailed in Volume I of the EDGAR Filer Manual. The FIXML data language requirement for Schedule 10B would not impose additional incremental compliance costs on reporting parties, because any reporting party without experience or expertise surrounding FIXML could choose to input its Schedule 10B reports in a fillable online form, rather than submit its reports directly in the FIXML data language. Filers who choose the

[238] The Commission estimates, at most, approximately, 136 reports per week (79 as a result of net threshold breaches, and 57 as a result of gross thresholds breaches) related to single-name thresholds. The analysis is based on DTCC–TIW data, which uses weekly holdings of single-name. *See infra* section VI.D.2.iii.(A).

[239] The Commission believes that the market for TRS is smaller than the market for CDS, and the CDS single name market is the representative market for security-based swaps in general, hence the Commission expects fewer reports from TRS compared to single-name CDS.

[240] *See supra* section V (quantifying a subset of the costs associated with proposed Rule 10B–1—specifically, the burden of information collection costs estimated for the purposes of the Paperwork Reduction Act).

[241] Should a reporting entity choose to obtain an LEI, the initial and renewal fees would vary based on the home jurisdiction of the reporting entity. *See https://www.gleif.org/en/about-lei/get-an-lei-find-lei-issuing-organizations.* A U.S. entity can obtain for a one-time fee of $65 and an annual maintenance fee of $50 per year. *See, e.g., https://lei.bloomberg.com/docs/faq#what-fees-are-involved.* Prices were retrieved from Bloomberg Finance, L.P., one of twelve LEI Operating Units that are accredited to issue LEIs to U.S. entities. Similarly, the other standard identifier requirements (FIGI for securities and product ID for security-based swaps) are not expected to result in compliance costs for reporting persons. FIGIs are automatically assigned and are retrievable and redistributable at no cost. Product IDs are required to be reported for all security-based swap transactions per Rule 901 of Regulation SBSR, so a reporting person would not incur any incremental cost associated with obtaining a product ID for the purposes of Schedule 10B. *See* 17 CFR 242.901(c)(1).

submit the required Schedule 10B reports directly in FIXML rather than use the online form, and who do not have experience structuring data in FIXML, would incur incremental implementation costs associated with developing the necessary expertise and establishing the necessary compliance processes (*e.g.,* encoding and maintaining the required data in FIXML and transmitting the data to EDGAR) to comply with the FIXML requirement. For those filers, and for other filers choosing to submit Schedule 10B reports directly in FIXML, the Commission expects that the automated processing enabled by the structured data requirement would make subsequent compliance costs lower than the compliance costs of manually inputting Schedule 10B reporting into the web form with each submission.

With respect to timing, proposed Rule 10B–1 would require security-based swap entities to file promptly but in no event later than the end of the first business day following the day of execution of the security-based swap transaction that results in the security-based swap exposure exceeding the reporting threshold. The cost of filing no later than the end of the first business day following the day of execution of the security-based swap transaction would likely not require the reporting party to invest in new IT infrastructure and automation. As discussed above, the Commission estimates 136 reports from U.S. entities per week in the single-name CDS market.[242]

In addition, proposed Rule 10B–1 may impact how security-based swap transactions take place across national borders. As discussed above, the reporting requirements of proposed Rule 10B–1 would be based on the reporting and public dissemination requirements in Regulation SBSR and, in addition, apply under certain circumstances when the reporting person holds any amount of reference securities underlying the Security-Based Swap Position (or would be deemed to be the beneficial owner of such reference securities, pursuant to Section 13(d) of the Exchange Act and the rules and regulations thereunder). This could place reporting persons at a disadvantage compared to non-reporting ones. U.S. security-based swap market participants and some foreign entities that would be required to report would be at a disadvantage, because they would be required to comply with proposed 10B–1 while some foreign participants would not be required to comply, while they would be able to access the publicly available reports required by proposed Rule 10B–1. As a result, a portion of reporting entities for whom these reporting costs are large might be incentivized to change their geographical location of operation to a non-U.S. jurisdiction and limit their participation in the underlying securities' markets. On the other hand, proposed Rule 10B–1 would likely increase the trading of non-reporting U.S. persons, as these thresholds would not affect them while providing them with additional transparency and reporting in the security-based swap market. Because of lower counterparty risk and improved market conditions, non-reporting U.S. persons may become more active in the security-based swap market.

iii. Reporting Thresholds

The costs and benefits of proposed Rule 10B–1 are dependent, in part, on which parties would be subject to the reporting requirements, as determined by the selected thresholds for each type of security-based swap. As a general matter, a higher threshold will lead to fewer reports. This may limit the benefits of the proposed rule, but decrease both the direct compliance costs and costs that investors face, as discussed above, when revealing information to the market that they consider material. In other words, a higher threshold would likely decrease reporting costs, but higher thresholds would resolve fewer of the asymmetric information scenarios that amplify the market imperfection. Similarly, a lower threshold, with more reports, may increase benefits associated with the proposed rule, but increase costs. We discuss below the expected number of affected parties at various thresholds, including the thresholds proposed in the rule.

(A) Thresholds for Credit Default Swaps

For single-name CDS and for narrow index-based CDS, the Commission has identified the threshold as the lesser of: (i) A long notional amount of $150 million, calculated by subtracting the notional amount of any long positions in a deliverable debt security underlying a security-based swap included in the CDS from the long notional amount of the CDS (the ''$150 million long threshold''); (ii) a short notional amount of $150 million; or (iii) a gross notional amount of $300 million. Calculations for the short notional amount threshold of $150 million would not add or subtract the notional amount of any positions in a deliverable underlying debt security, and calculations for the both the long and short $150 million notional amount thresholds would not net out any other Security Based Swap. In addition, persons who have previously filed a Schedule 10B with the Commission would be required to file amendments if any material change occurs in the facts set forth in a previously filed Schedule 10B including, but not limited to, acquisitions in an amount equal to 10% or more of the position previously reported in Schedule 10B.

Reporting following a trigger of the $150 million long or short threshold would inform the Commission, market participants, and the public in general about market positions with large potential market impact, which could lead to significant reduction of asymmetric information when reported. Further, the calculation method for the $150 million long threshold would limit reporting and reporting costs by excluding deliverable bonds, and help market participants identify situations where a counterparty has a higher likelihood of having incentives to undertake opportunistic trading strategies. However, at larger notional amounts, quickly converting to a long position potentially netted by deliverable bonds to only a long gross positon presents additional risk;[243] accordingly, the Commission is proposing a second larger threshold, $300 million notional on a gross basis, to capture overall large exposures.[244] By knowing that a counterparty has a large gross notional amount and is directionally[245] neutral, the party could accordingly adjust its price expectations and margin requirement of trading with that counterparty. This adjustment would account for the risk associated with trading with a counterparty that could quickly transform its directionally

[242] *See supra* section VI.D.2.iii (disclosure thresholds) on discussion related to how the Commission estimated the number of reports for single-name CDS market.

[243] For example, a market participant may hold a large gross position that is net neutral (non-directional), just below the gross reporting threshold and not be required to file Schedule 10B. Thereafter, the participant quickly converts the gross position to a directional position by offloading the more liquid side of the trade, thus quickly converting the net neutral to a large directional position.

[244] The Commission believes that these thresholds, together with those described below for non-CDS debt security-based swaps and security-based swaps on equity, would likely have triggered position reporting under circumstances similar to those described above with respect to observed instances of ''opportunistic strategies'' and scenarios of high counterparty risk. *See supra* section I.B.

[245] Directional positions are holdings where market participants are not net neutral (*i.e.,* their long and short positions do not net out) because said participants have an expectation about the future movement of an asset and expect to profit from the risk taken with the position.

neutral position to one directional in nature.

These thresholds limit the number of reporting parties that would be required to report and the related costs (including related to compliance and analyzing this information), while still addressing the market failure as a result of the adverse selection caused by asymmetric information in the market. For example, if the thresholds were lower the Commission would expect a larger number of reports, likely more uninformative ones with not sizable exposure, while increasing the burden to understand the reports, limiting the benefit of the overall reporting.

The Commission used single-name CDS positions data from DTCC–TIW to estimate: (a) The number of market counterparties in the CDS market affected by proposed Rule 10B–1 for various thresholds; (b) the number of initial reports that would likely need to be filed on a weekly basis for various thresholds, as well as the number or amendments that might as a result of material changes; and (c) the percent of market participants that would be required to file no reports per week, (0–10) reports per week, [10–20) reports per week, or more than 20 reports per week, based on data from January 1, 2020 to December 31, 2020.[246] We discuss these estimates in detail below.

Estimate of the Number of Market Counterparties in the CDS Market Affected by Proposed Rule 10B–1

To understand the number of market counterparties in the CDS market affected by proposed Rule 10B–1 at potentially different threshold levels, the Commission calculated concentration statistics for the year 2020, as shown in Figure 2 below. To perform this estimate, the Commission calculated the number of parties that might be impacted at different long/short notional amounts and gross thresholds represented with seven buckets: [0–50), [50–100), [100–150), [150–200), [200–250), [250–300), and [300+) in millions of US dollars. Each bucket represents the percent of accounts with exposure in a week for at least one underlying entity.[247]

Figure 2: Global distribution of notional trading volume[248] in North American corporate single-name CDS, and U.S. entities' accounts in any single-name CDS, year 2020

As shown in Figure 2 (left), roughly 88% of accounts—hold a position larger than the short notional exposure of $150 million, and less than the long net exposure of $150 million. 5% of accounts have a position larger short position than the $150 million short notional exposure, while 7% of accounts have a larger long position than the $150 million long notional exposure. This estimate for accounts affected by the long dollar exposure threshold is an upper bound, as it does not account for offsetting holdings in the deliverable bonds. [249] The Commission does not have access to granular data on bond holdings and so cannot compute the net positions if these positions were hedged by deliverable bonds. Hence, the Commission expects that fewer than 12% (5% from short positions larger than $150 million, and 7% from long positions larger than $150 million) of market participants would be impacted by the reporting requirements in proposed Rule 10B–1, as a result of the $150 million notional amount threshold for both long and short positions. Similarly, only 9% of accounts on average hold a gross exposure on a single name underlying entity of more than $300 million, the last of the thresholds, [300, +).

Further, to understand the size and jurisdiction of underlying entities referenced by single-name CDS, Commission staff performed additional

[246] For specific notation, the following bucket, [0–50), means that 0 is included in this bucket, while 50 is not included in the bucket.

[247] DTCC–TIW includes weekly CDS positions for all U.S. entities, or foreign counterparties to a U.S. entity, or foreign counterparties trading CDS referencing a U.S. underlying entity. By aggregating available position information, the Commission is able to calculate exposure.

[248] A long notional exposure is indicated with positive values, while a short notional exposure is indicated with negative values.

[249] Bonds of the underlying entity that are delivered in the auction are a subset of all underlying referenced debt that the underlying entity may have. This subset more closely tracks the value of the CDS as only those bonds would determine the final recovery value and the CDS payoff. *See, e.g.,* the Big Bang protocol: *https://www.cdsdeterminationscommittees.org/companies/auctionhardwiring/auctionhardwiring.html.*

analysis using the DTCC–TIW data. The left chart shows the size distribution of US firms. Most US firms that have a referencing CDS are large, with 57% of them having an average of $10 billion or more in total book value of assets at the end of year from 2009 to 2020.[250] The right chart shows the country distribution of single-name CDS reported in DTCC–TIW. 33% are underlying entities referenced in the US, followed by approximately 22% in the European Union.

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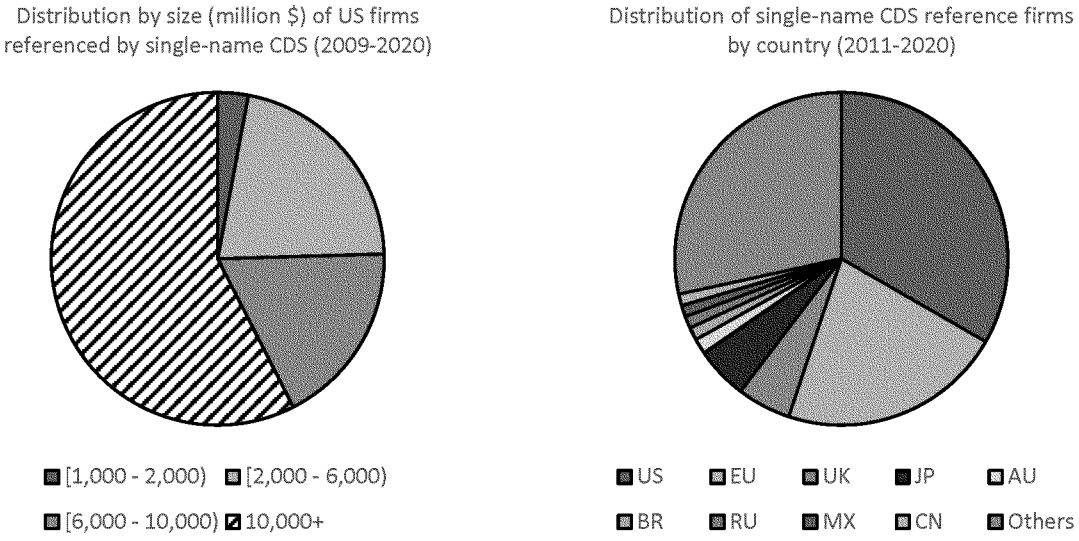
Figure 3: The distributions of the size of US firms referenced by single-name CDS (left) and the jurisdictions of firms referenced by single-name CDS as reported by DTCC-TIW (right)



Estimate of the number of reports to be filed on a weekly basis

Commission staff used single-name CDS positions data from DTCC–TIW to evaluate the number of initial reporting that would likely need to be filed on a weekly basis, as well as the number of amendments that may need to be filed because of the requirement to file amendments in connection with material changes. Commission staff performed this analysis on two samples. The first sample, shown in Figure 4, uses all exposures on single name North-American CDS underlying entities and all exposures of U.S. single-name CDS participants. The second sample, shown in Figure 5, narrows the analysis to only U.S. single-name CDS participants (counterparties), and does not consider foreign single-name counterparties who have exposure to North-American CDS.[251] This is a subset of the DTCC–TIW data, which includes U.S. counterparties in the single-name CDS market, and covers both U.S. counterparties' North American and foreign underlying entities CDS holdings. The left charts in Figure 4 and Figure 5 show the number of reports the Commission expects to receive weekly (y-axis) for each sample across various long/short thresholds (x-axis) and for different material percent changes, represented by different lines in the chart. The black line represents the threshold levels selected by the Commission.

[250] This value represents the average end of year book value for each firm, as reported in Compustat. Similar statistics regarding the size of the single-name CDS are reported in Lee, Naranjo, and Velioglu, *supra* note 229 at 556–78.

[251] Commission staff considered all DTCC–TIW entities' aggregate weekly holdings across accounts all single-name CDS in 2020, for 52 weeks. Commission staff then assumed that the proposed reporting requirements from proposed Rule 10B–1 were implemented from the first week of 2020. For entities on an aggregate level, Commission staff then assessed the number of reports different potential reporting thresholds and weekly material changes would have. The analysis then aggregates the number of triggers for each firm's entire single-name CDS positions in 2020 across 52 weeks. For example, Figure 5, considers the following reporting net (left plot) and gross (right plot) thresholds listed on the x-axis: $50 million, $100 million, $150 million, $200 million, $250 million, $300 million and $500 million and material percentage change (lines at 1%, 5%, 10%, 20%, and 30%).

Figure 4: Expected number of reports by global security-based swap participants' exposure to North American single-name CDS and U.S. security-based swap participants' exposure to single-name CDS across long/short and gross thresholds

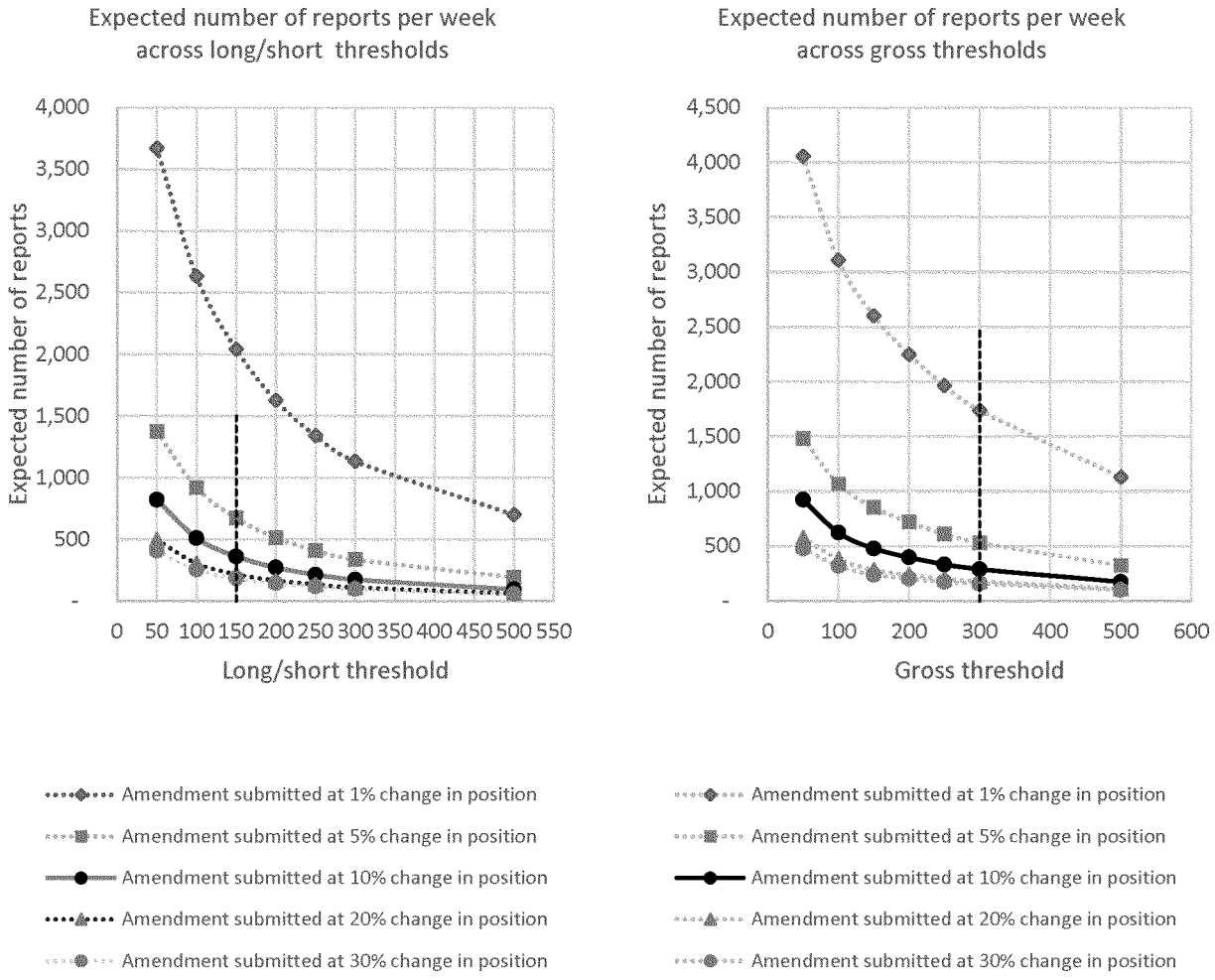
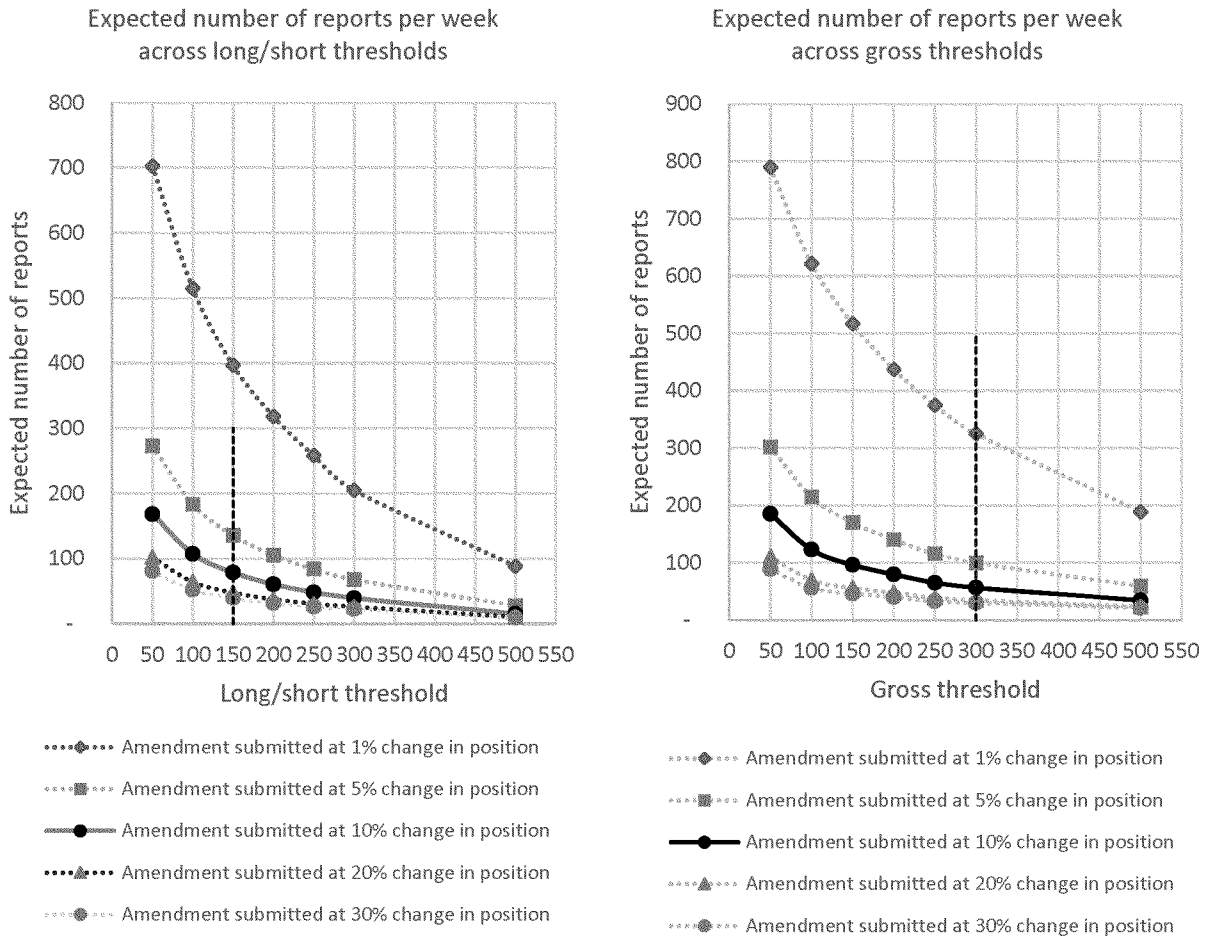


Figure 5: Expected number of reports by U.S. security-based swap participants across long/short and gross thresholds



The left chart in Figure 5 shows that the Commission expects slightly more than 79 reports per week as a result of U.S. entities triggering the long/short proposed thresholds of $150 million with a material percent change threshold of 10%, as it relates to CDS. Similarly, the right chart in Figure 5 represents the number of reports the Commission expects to receive weekly from U.S. entities across gross thresholds (x-axis) and different material percent changes. The right chart in Figure 5 shows that the Commission expects an additional 57 reports per week as a result of U.S. entities exceeding the gross proposed threshold of $300 million with a percent change of 10%. In total, the Commission expects at most 136 reports per week from U.S. entities with respect to CDS positions, 79 reports as a result of the long/short thresholds and 57 reports as a result of the gross threshold.[252]

These estimates are upper bounds for U.S. entities because Commission staff cannot net out deliverable bonds due to limited data. Such data limitations relate to the bond holdings of security-based swap participants that would be eligible to offset the net positions and that would decrease the single-name net exposure. In addition, the proposal would require reporting by the party with the swap exposure (*e.g.,* a pension fund or industrial company, but not the investment adviser who trades on behalf of this party). Because Commission staff analysis is at the level of entities in Table 1, which pools exposures of the underlying parties, the analysis overestimates the right-skewness of the distribution of exposures, and hence overestimates the number of entities reporting. As a result, this methodology correctly captures entities that might directly report to DTCC–TIW across several of their individual accounts, as the methodology captures the entities' aggregate exposure. Parallel to this, the methodology overestimates the size of the holdings of parties that act as dealers in the single-name CDS market because it aggregates the accounts of market participants that are reported to DTCC–TIW as being held by the dealer. In addition, Commission staff only observed end-of-week exposures, hence intra-weekly changes in position that might breach these thresholds were not accounted for. There are a limited

[252] In addition to these 136 reports, the Commission also expects a number of foreign entities to report based on a similar analysis using DTCC–TIW data. Including foreign entities, the Commission believes that there will be is a total of 362 reports a week as a result of the net threshold, 79 reports from U.S. entities and 283 from foreign entities. If the gross threshold is used, the Commission estimates 291 reports a week, including 57 reports from U.S. entities and 234 reports from foreign entities. The Commission believes that these numbers may be overestimated because: (i) Only foreign entities that hold underlying U.S. securities would need to report; (ii) the Commission's analysis considers aggregate holdings across all accounts, hence this methodology correctly captures entities that might directly report to DTCC–TIW across several account, but overestimates the size of holdings of parties that directly report to DTCC–TIW, but while acting as dealers in the single-name CDS market by having accounts other participants; and (iii) there may be entities that trigger both thresholds simultaneously (*e.g.,* if an entity hold as a gross position of $300 million with a net position of $150 million) so those entities would be double counted in these figures.

number of such dynamic intra-weekly changes in positions, as participants are more likely to hold longer-term swaps positions.[253] In addition, the analysis does not account for reports that might be filed as a result of an entity triggering both long/short and gross threshold breaches in the same week. For example, a large long or short position and a large gross position happening contemporaneously would be counted twice in the estimation (once in each sample). These overestimations, for the number of U.S. entities and for all reporting parties in DTCC–TIW, lead the Commission to believe that the estimated number of weekly reports are likely overestimated, and the Commission expects significantly fewer reports per week in practice.

Estimate of the Percent of Market Participants That Would be Required To File Certain Numbers of Reports

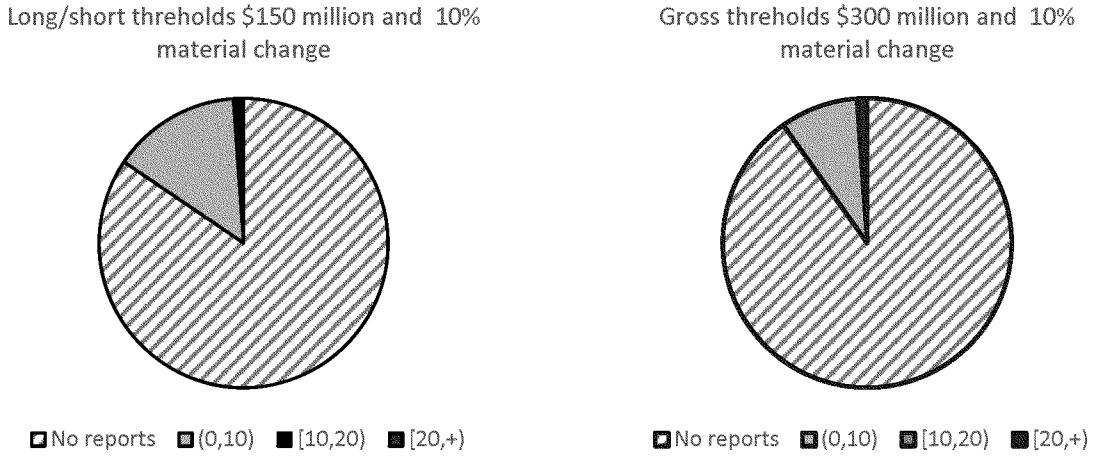
In Figure 6 below, using DTCC–TIW data, the Commission estimated the percent of market participants that would be required to file reports based on data as of January 1, 2020. Specifically, the analysis breaks down how many participants would file, on average, no reports per week, (0–10) reports per week, [10–20) reports per week, or more than 20 reports per week.[254] Figure 6, is based on global security-based swap participants with exposure to North American single-name CDS and U.S. security-based swap participants with exposure to any single-name CDS. Because Figure 6 includes all available positions in the DTCC–TIW data (including some positions of foreign entities not trading securities referencing U.S. entities, who would not be required to report under the proposed rule), this analysis likely overestimates the percent of the market participants required to report. The Commission has, therefore, provided a second estimate in Figure 7, below, which represents only U.S. security-based swap participants' exposure to any single-name CDS. The Commission expects that many reports will be filed by SBSDs because, as liquidity providers, they will likely interact with clients executing large positions in CDS or TRS, and further, SBSDs are likely to hedge these positions.

Figure 6: Percent of Global security-based swap participants with exposure to North American single-name CDS or U.S. security-based swap entities with exposure to single-name CDS that would have filed weekly reporting in 2020.[a]

[a] The Commission lacks data on specific foreign entity holding of U.S. bonds. As a result, this analysis does not account for foreign entities with no ownership of the underlying security that might be required to report in certain circumstances and that are in upper bounds for the number of expected reports from foreign entities.

[254] The following bucket, (0–10), means that neither 0 nor 10 are included in this bucket.

Figure 7: Percent of U.S. entities with exposure to single-name CDS that would have filed weekly reporting in 2020.



As shown in the left chart in Figure 6, the Commission estimates that 22% of global security-based swap participants with exposure to North American single name CDS and U.S. entities with exposure to single-name CDS would be required to file, on average, fewer than 10 reports per week as a result of reaching the $150 million long/short thresholds and the 10% change in position that would require the filing of an amendment. Furthermore, the Commission estimates that only 1% of global participants in the security-based swap market with exposure to North American single name CDS and U.S. entities with exposure to single name CDS would be required to file more than 20 initial reports or amendments on average in a week as a result of the $150 million threshold. Similar estimates are shown for U.S. entities alone in Figure 7, with a cumulative 99% of U.S. entities filling less than 10 initial reports or amendments on average a week. Likewise, only 1% of U.S. single-name CDS market participants would need to file more than 10 initial reports or amendments per week on average. Similar to previous estimates, long/short threshold estimates presented in Figures 6 and 7 are conservative upper bound estimates, as the Commission cannot adjust for bond positions that would offset the size of the CDS holdings, as well as aggregate positions that might be reported in DTCC–TIW across one or many different dealers.

Commission staff performed a similar analysis for the gross threshold at $300 million for both groups of participants. As shown in Figure 7, the Commission estimates that 90% of U.S. single-name CDS market participants will, on average, not be required to file any reports under the proposed Rule 10B–1 for the gross threshold, while if required to file, 9% of U.S. single-name CDS participants would be required to file fewer than 10 reports on an average week, and only 1% of U.S. security-based swap market participants would be required to file more than 20 initial reports or amendments per week on average.[255]

(B) Thresholds for Non-CDS Debt Security-Based Swaps and Security-Based Swaps on Equity

As discussed above, the Commission is proposing: (i) For security-based swaps based on equity, a bifurcated approach, such that a reporting obligation would be triggered by exceeding the lesser of a threshold based on the notional amount of the Security-Based Swap Position, and a threshold based on the total number of shares attributable to the Security-Based Swap Position as a percentage of the outstanding number of shares of that class of equity securities and (ii) for other non-CDS debt security-based swaps, a notional based threshold approach. In addition, persons who have previously filed a Schedule 10B with the Commission would be required to file amendments if any material change occurs in the facts set forth in a previously filed Schedule 10B including, but not limited to, acquisitions in an amount equal to 10% or more of the position previously reported in Schedule 10B.

The Commission believes that these thresholds achieve the goal of informing the market and the public about impactful and directional positions in TRS, which could lead to significant reduction of asymmetric information when reported. The notional thresholds of $300 million (which includes not only the TRS or other equity security-based swaps and related securities) of which $150 million (which includes only the TRS or other equity security-based swaps) provides a bright-line, absolute measure of position size and is similar to the approach proposed for CDS. The bright-line provides a simple and specific reporting threshold for participants. We are also proposing a threshold based on the total number of shares attributable to the Security-Based Swap Position as a percentage of the outstanding number of shares of that class of equity securities. The 5% threshold relative to market capitalization (out of which 2.5% are in TRS and equity security-based swaps) is required because there are a large number of firms in the market that would not be captured by the notional thresholds, which the Commission believes should be captured in order to reduce asymmetric information problems in the TRS market. Based on the Commission's analysis, smaller underlying entities make up a significant portion of the U.S. firms referenced by TRS. For smaller underlying entities to be adequately captured and thereby effectively to reduce asymmetric information in the market for swaps referencing their securities, the Commission believes a percentage threshold is required. This is demonstrated in Figure 7.

In evaluating the effect of these thresholds, the Commission used data from Form N–PORT filings, which include information on holdings of, among other things, security-based swaps, to (a) estimate the number of

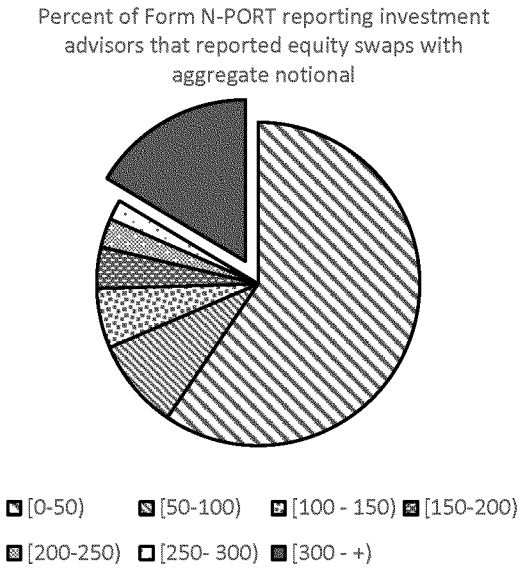
[255] The analysis has a similar limitation as noted above in ''Estimate of the number of reports to be filed on a weekly basis.''

market counterparties affected by proposed Rule 10B–1's notional thresholds for non-CDS debt security-based swaps and security-based swaps on equity and (b) analyze the size and jurisdiction of underlying entities referenced by total return, equity, and other non-CDS, debt security-based swaps. We discuss these analyses in detail below.

Estimate of the Number of Market Counterparties in the Market for Non-CDS Debt Security-Based Swaps and Security-Based Swaps on Equity Affected by Proposed Rule 10B–1

Using data from each fund's [256] latest Form N–PORT filing as of November 15, 2021, Commission staff estimated the percent of accounts with TRS aggregate positions within certain buckets of notional size, where each bucket represents the percent of accounts with TRS aggregate positions within the corresponding notional size. For example, 84% of funds reporting on Form N–PORT hold an aggregate position of $300 million or less in TRS, while 16% of these funds have an aggregate position to TRS of $300 million or more.

Figure 8: Aggregate Positions based on each fund's latest Form N-PORT filling as of November 15, 2021



Numerical depiction of the right skewed distribution of

Form N-PORT funds

Form N-PORT fund statistics	
25th percentile	$24 thousand
50th percentile	$131 thousand
75th percentile	$713 thousand
Average	$10.6 million

In addition, based on data from each fund's latest Form N–PORT filing as of November 15, 2021, the Commission provides several relevant summary statistics: First, there are 21,211 TRS being reported across 652 funds from Form N–PORT fillings; second, the median size of aggregate TRS positions of N–PORT reporting filers' funds is $131,000, while the average size is $10.6 million. These summary statistics imply that the TRS holdings of N–PORT-reporting filers' funds are right-skewed [257] and that these entities in aggregate hold a very limited position in total returns swaps. Lastly, the 25th and 75th percentiles are $24,000 and $713,000, which implies that 75% of N–PORT reporting filers' funds participate in the TRS market hold less than $713,000 in these products.[258] Based on the distribution demonstrated by this analysis, the Commission believes only a limited number of N–PORT filers' funds would be exceed the 10B–1 reporting requirement.[259]

Evaluation of Size and Jurisdiction of Underlying Entities Referenced by Total Return, Equity, and Other Non-CDS, Debt Security-Based Swaps

[256] For purposes of this discussion, ''funds'' are series of registered investment companies or registered investment companies if there are no series.

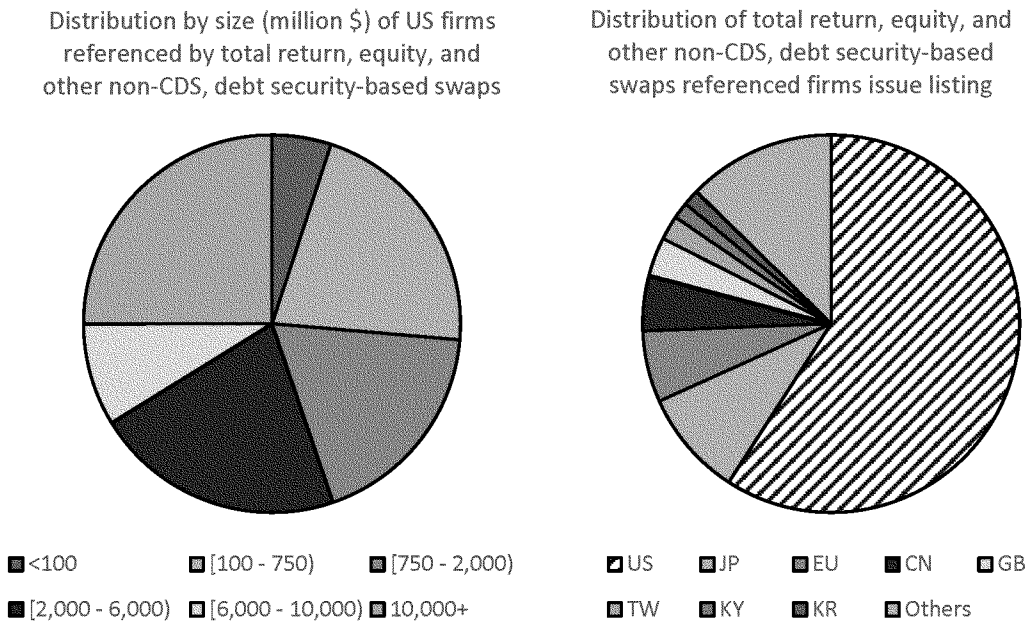
[257] A ''right-skewed'' distribution is one in which the tail is on the right side, and typically the mean (average) is greater than the median.

[258] Due to data limitations, the Commission's analysis does not separate the analysis into individual types of TRS.

[259] The Commission recognizes that Form N–PORT reporting filers may not be representative of the ''average'' trading entity in the security-based swap market and in particular, the ''average'' trading entity in the total return, or equity swap market. The Commission believes that Form N–PORT-reporting investment funds are likely to be less leveraged and participate in a smaller number of transactions compared to other entities that participate TRS market. *See generally* 17 CFR 270.18f-4 (''Rule 18f-4'') (limiting the ability of registered investment companies and business development companies to engage in transactions that involve potential future payment obligations, including obligations under derivatives such as forwards, futures, swaps and written options). Hence, the quantitative analysis provided on TRS using Form N–PORT reporting entities is likely to be biased towards TRS market participants that are more risk averse, less active in the TRS market, and more likely to currently be subject to reporting requirements and leverage limitations. This will result in estimates that would likely suggest a lower bound on the number of potential entities subject to the Rule 10B–1 disclosure requirement. In addition, due to data constraints, offsetting positions are not being reflected in this analysis. This would mean that the ''average'' TRS market participant is likely to be more active, less risk averse, and likely have larger exposures and positions in the TRS market. Despite the Commission's current data constraints regarding TRS, the Commission believes that these data provide useful market insight into the number of participants in the TRS market that might be impacted by the new reporting requirements. Certain information on Form N–PORT is non-public, while certain information reported on Form N–PORT for the third month of each filer's fiscal quarter is made publicly available upon filing.

Commission staff also analyzed the size and jurisdiction of underlying entities referenced by TRS, equity security-based swaps, and other non-CDS, debt security-based swaps. In Figure 9, the Commission performed a name matching procedure across Compustat [260] and N–PORT data as of November 15, 2021 determine the size of U.S. entities referenced by total return, equity, and other non-CDS, debt security-based swaps, and jurisdiction of entities referenced by total return, equity, and other non-CDS, debt security-based swaps.[261] Using total assets and two digit ISIN country identifiers available from Compustat for the merged dataset, the analysis resulted in two distributions. The left distribution shows that 44% of entities referenced by TRS, equity security-based swaps, and other non-CDS, debt security-based swaps reported in Form N–PORT have total asset size less than $2 billion. The right figure shows that a significant majority, 59%, of entities referenced by TRS, equity security-based swaps, and other non-CDS, debt security-based swaps reported in Form N–PORT have underlying securities traded in the U.S.

Figure 9: The approximate distributions[a] of the size of firms referenced by total returns swap as reported in Form N-PORT (left) and the jurisdictions of the issues listing (right)



[a] Due to data limitations, no common indicators between the two data sets used in this analysis, COMPUSTAT and N-PORT, the Commission performed a name matching across the two data sets, which might lead to potential mismatch.

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This analysis indicates that there is likely a significant proportion of smaller to medium sized firms—including, for example, firms with less than $2 billion and between $2 and $6 billion in total book value of assets, respectively—which are underlying entities to total return, equity security-based swaps, and other non-CDS, debt security-based swaps as reported by funds that file Form N–PORT. In addition, the analysis indicates that the majority of these underlying entities have securities issued in the U.S. as identified by their two-digit ISIN code. A notional threshold (such as $300 million) would not capture the security-based swap exposure in the initial stages of accumulating a large position for a significant portion of smaller to medium sized firms. A $300 million notional exposure would correspond to a 5% percent threshold of an underlying entity with a $6 billion market capitalization. This would correspond to less than approximately 34% of underlying entities, entities with total assets greater than $6 billion. Hence, the requirement of a percent threshold would help inform the market of total return, equity security-based swaps, and other non-CDS, debt security-based swaps exposures for medium and smaller underlying entities.

While the Commission acknowledges that TRS, equity security-based swaps, and other non-CDS, debt security-based swaps exposures to the medium and smaller underlying entities do not pose large counterparty default risk compared to swap exposure on larger

[260] The analysis uses Compustat Global and Compustat North America. Compustat Global provides authoritative financial and market data covering publicly traded companies in more than 80 countries, representing over 90% of the world's market capitalization. Compustat Global includes coverage of over 96% of European market capitalization and 88% of Asian market capitalization.

[261] This analysis was subject to certain data limitations. In particular, the Compustat and N–PORT data contain no common identifiers between the two datasets. As a result, this might lead to potential mismatches because the merge was performed through a name-matching algorithm.

firms, security-based swaps based on securities issued by medium and smaller underlying entities have the potential to impact the underlying entity and its shareholders. This is likely because the underlying security referenced by such security-based swaps is more likely to be less liquid than underlying securities of large entities. The lower liquidity levels in the underlying security would be more prone to movement away from fundamentals because of offsetting activity in the total return, equity security-based swaps, and other non-CDS, debt security-based swaps. For example, Firm XYZ might buy TRS on underlying Firm ABC from Firm 123. To hedge its short exposure to the issued TRS, Firm 123 buys the underlying security of Firm ABC. Volatile market activity can result in margin calls from Firm 123 to Firm XYZ leading Firm 123 to sell some or all of its position in the underlying security. This quick and large selling of the underlying security by only one agent may trigger a more pronounced fire sale, which is a large sale of securities below market value. These sales dislocate the price away from its fundamental value.

A threshold based on the total number of shares attributable to the security-based swap position (as a percentage of the outstanding number of shares of that class of equity securities) could, however, help alleviate large changes in prices due to purchase or sales of the underlying security. Because this threshold would be tied to the outstanding number of shares, this threshold would effectively be lower for smaller firms—which would ensure that, when large positions are acquired, market participants could be made aware through Schedule 10B reports.

In addition, data analysis undertaken by the Commission staff shows that the number of investment companies that file Form N–PORT who would be captured by this new reporting requirement is likely to be small.[262] Other types of market participants that are not registered with the Commission under the Investment Company Act, such as family offices, endowments and private funds, may have lower risk aversion, higher TRS exposures, and may trigger the reporting threshold more than N–PORT filers.[263] The Commission estimates that 84% of the funds reporting on Form N–PORT as of November 15, 2021 hold an aggregate exposure of less than $300 million in TRS, while 14% of reporting funds have an aggregate exposure to TRS of $300 million or more. These percent estimates may not be indicative of the number of reports the Commission expect to receive.

E. Reasonable Alternatives

1. Implementing a More Prescriptive Approach in Re-Proposed Rule 9j–1

One potential alternative to the approach taken in re-proposed Rule 9j–1 would be to identify and prohibit within the rule specific types of events (for example, market behavior around certain events and fact patterns) and ''opportunistic trading'' behavior that have been observed. 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. This approach could, however, 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 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 proposed approach in the market for security-based swaps, as well as the market for the referenced underlying of such security-based swaps.

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

The Commission could add a conditional safe harbor from re-proposed Rule 9j–1 for entering into security-based swap transactions, while in possession of material non-public information, for purposes of hedging some or all exposure arising out of lending activities with a reference entity or the syndication of such lending activities. Such a conditional safe harbor could minimize the effects of the re-proposed 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. We believe that 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 conditional safe harbor designed to apply solely to legitimate hedging transactions could unintentionally apply to activities proposed Rule 9j–1 is designed to prohibit, reducing the benefits of the rule. Further, such a conditional safe harbor would need to be balanced against the risk that market participants undertake transactions for which their counterparties should have the protections of the re-proposed Rule 9j–1, including in circumstances involving potentially opportunistic trading strategies.

3. Mandating That Security-Based Swap Data Repositories Report or Publicly Disclose Positions

The Commission could consider placing the reporting obligations on registered SBSDRs. Although this alternative would relieve market participants of additional reporting obligations and, given some reporting requirements are already in place, eliminate some additional reporting costs, this alternative would preclude inclusion in the reported data of key aspects of the reporting requirement proposed to be required by Rule 10B–1—the identity of the person building up a large security-based swap position and information regarding the underlying entity. Requiring that the SBSDRs report the applicable information would be subject to significant limitations that could undermine the effectiveness of the rule. Specifically, and as discussed above, Section 13(m)(1)(C)(iii) of the Exchange Act provides that any rulemaking pursuant to Section 13(m) (*i.e.,* Regulation SBSR) must be structured in such a manner ''that does not disclose the business transactions and market positions of any person.'' [264] Accordingly, such an alternative could involve only anonymized reporting, thereby negating one of the key benefits of the rule, *i.e.,* providing counterparties an opportunity to take certain protective actions when transacting with counterparties with a large, concentrated security-based swap position.

Further, this alternative would likely impose significant burdens on the SBSDRs, who would be required to report when the security-based swap entity breaches the specified gross

[262] *See* discussion related to the size of TRS holdings in Evaluation of Size and Jurisdiction of Underlying Entities Referenced by Total Return, Equity, and Other Non-CDS, Debt Security-Based Swaps.

[263] *See* discussion related to the limitation of Form N–PORT data in Evaluation of Size and Jurisdiction of Underlying Entities Referenced by Total Return, Equity, and Other Non-CDS, Debt Security-Based Swaps.

[264] *See* 15 U.S.C. 78m(m)(1)(C)(iii).

thresholds. This would likely require investments from the SBSDR in an automated reporting system, which would track, aggregate, monitor, and report exposures. In addition, given SBSDRs may not be aware of all positions held by a market participant, this alternative would limit the potential thresholds to only gross thresholds. These limitations could substantially undermine the benefits of the proposed rule.[265] This additional data provides important context for the information, such as whether holdings are hedged or not. In addition, if the rule were to require reporting of only gross thresholds, market participants may learn of large position buildup only. For example, a market participant may hold a large gross position that is net neutral (non-directional), just below the gross reporting threshold and not be required to report on Schedule 10B. Thereafter, the participant could quickly convert the gross position to a directional position by offloading the more liquid side of the trade, thus quickly converting the net neutral to a large directional position. As a result, the Commission does not believe this is the appropriate method of reporting.

4. Adopting Position Limits

Another possible alternative to proposed Rule 10B–1 and 9j–1 would be to adopt position limits in lieu of reporting requirements. These position limits would prohibit market participants from building up large, concentrated positions in security-based swaps. As compared with reporting, this would limit the ability of market participants to hedge underlying exposures. Further, given that transparency allows market participants to adjust counterparty exposures, it is unclear whether position limits would have substantially greater benefits to risk reduction and exposure to opportunistic strategies as compared with the proposed reporting. The Commission acknowledges, however, that to the extent that market participants would not make such adjustments, position limits could have risk reduction benefits beyond those associated with reporting.

5. Threshold Alternatives for Security-Based Swaps Based on Equity and Non-CDS Debt

The Commission could consider alternative approaches for calculating potential thresholds for security-based swaps based on equity and non-CDS debt. Specifically, the Commission could consider proposing reporting thresholds based on:

- The average daily trading volume (''ADTV'') of the relevant securities, such that reporting would be required if the number of shares represented by the security-based swap exceeded a certain percentage of ADTV.
- Notional values that vary based on types of equity underlying the equity-based swap, including for example, equity issued by emerging market issuers or large and small capitalization issuers. Such an alternative could resemble existing industry methodologies for calculating margin on derivatives.[266]
- For non-CDS debt, a bifurcated approach, such that the threshold would be defined to include both a threshold based on the notional amount of the position, and a threshold based on the percentage component (for example, notional divided by market value of total issuance).

Using a threshold that would adjust based on ADTV could better approximate when the market for an underlying security could be impacted with a large security-based swap, as compared to the proposed approach. For example, large positions relative to ADTV could affect the market for the underlying security if a party needed to exit that position in a short period of time, which could require having to liquidate any securities being held to hedge the security-based swap. Such a metric may not, however, be meaningful with respect to non-CDS debt security-based swaps, given that debt securities do not trade widely in the secondary market.

However, because these alternatives would be inconsistent with the proposed thresholds for CDS and be more complicated to calculate, they could increase compliance costs for market participants. Moreover, a metric based on ADTV would require security-based swap counterparties to monitor the trading volume of those shares, and because ADTV can fluctuate on a day-to-day basis, particularly during times of high volatility, such fluctuations could require persons trading large positions in security-based swaps to develop more sophisticated systems for monitoring those positions as a function of ADTV. A threshold that would vary based on the types of equity underlying the equity-based swap could potentially lead to additional computation complications. For example, it would require security-based swap market participants to track different thresholds for different types of underlying securities.

With respect to the potential inclusion of a bifurcated approach for non-CDS debt swaps, there would potentially not be a substantial benefit to including a percent component in this threshold. Specifically, comparing a notional amount to a bond market capitalization denominator would likely not indicate meaningful information about the holder's ability to affect the market for the underlying bond market. In addition, a calculation based on a bond market capitalization denominator[267] would be bond issue specific, making the calculation unique to every bond. This would likely increase the costs to market participants to maintain compliance.

6. Threshold Alternatives for Credit Default Swaps

An alternative approach to the public reporting requirement in Rule 10B–1 would be to consider different methodologies for calculating the reporting thresholds for single-name CDS. When considering different reporting methodologies for single-name CDS, the Commission also could consider proposing:

- A single gross threshold that would require single-name CDS trading entities to report their exposure and related holdings after the entity exceeds a certain level of their aggregate CDS exposure for a single underlying entity without accounting for offsetting deliverable securities. For example, even if a CDS market participant were net neutral (*i.e.,* no directional exposure), because it has large exposures both in the long and short direction it would have to reveal this information to the market at certain thresholds.
- A single net threshold that would require single-name CDS trading entities to report their exposure and related holdings after the entity exceeds a certain level of their net single-name CDS position (*i.e.,* allows the reporting entity to offset or account for hedged positions). This is one of the two components of the 10B–1 reporting threshold. This alternative would thus only capture large directional exposure.

[265] Even to the extent that anonymized data would be sufficient, the data provided to the SBSDRs pursuant to Regulation SBSR is unlikely to be useful as a way of potentially alleviating the compliance burdens of Rule 10B–1, absent a rulemaking to amend Regulation SBSR. For example, SBSDRs are currently permitted to apply a cap to the anonymized dissemination of CDS transactions, such that if the trade exceeds $5 million, it will be disseminated as ''$5MM+'' in lieu of the actual amount, mirroring how cash corporate bonds are disseminated by TRACE. In addition, data reported to an SBSDR relates only the security-based swaps themselves. By contrast, Section 10B–1 allows the Commission to require reporting of both a security-based swap position and any security or loan or group or narrow-based security index of securities or loans related to the security-based swap.

[266] *See, e.g.,* ''ISDA SIMM Methodology, version 2.3,'' *available at: https://www.isda.org/a/oDHTE/ISDA-SIMM-v2.3-PUBLIC.pdf.*

[267] In addition, this methodology would not capture private placement bonds as they are unregistered debt securities only sold to accredited investors.

• Thresholds based on net or gross notional of single-name CDS positions relative to total net or gross outstanding CDS, outstanding bonds, or total deliverable bonds related to the single-name CDS. For example, market participants could be required to report if their net CDS position, as discussed above, divided by total outstanding bonds exceeds, for example, a 5% threshold or other percent threshold.[268]

• Calculating the short notional amount threshold of $150 million by adding or subtracting the notional amount of any positions in a deliverable underlying debt security and/or calculating both the long and short $150 million notional amount thresholds by netting out any other Security Based Swap, specifically, single-name CDS with the same maturity, referencing the same underlying entity.

The first two alternative approaches may be a less burdensome means of achieving the goal of disclosing concentrated positions, as fewer reports would be required. We believe, however, that requiring only gross or netted reporting would substantially reduce the benefits of the proposed rule. Specifically, without a netted reporting requirement, market participants would not be aware of the true market exposure, while without a gross reporting requirement, a single-name CDS entity could present substantial systematic risks without triggering a reporting obligation. For example, if there is no requirement to report a net neutral position even though the aggregate gross position is significant, then the entity's position could quickly become directional by closing the offsetting position.[269] The same situation might happen for a small net exposure that is below the net reporting threshold, but with a large aggregate gross exposure.

Further, if the Commission were to use a single gross threshold, a selected threshold would have to be significantly lower than the one included in the proposal to capture market events similar to those captured under the proposed threshold. This would increase the overall number of reports and would likely capture a large number of positions immaterial to addressing asymmetric information problems. Each uninformative report would dilute the value of each informative report by increasing overall costs of processing and providing the required information to other market participants.

With respect to the third alternative, a threshold based on the notional of single-name CDS positions relative to total outstanding CDS, outstanding bonds, or total deliverable bonds would have the benefit of capturing more positions related to smaller underlying entities, which might be more prone to being impacted by opportunistic strategies compared to larger firms. This alternative could, however, be challenging for market participants to implement. First, it not clear how market participants would calculate total outstanding CDS, which could increase the costs of implementing the alternative. Second, unlike underlying securities for equity swaps, bonds with different vintages and yields are not fungible securities, meaning that they are not equivalent or interchangeable. As a result, selecting the ones to aggregate uniformly across all underlying entities when calculating the denominator increases the difficulty and costs of the calculation. For example, not all bonds would be deliverable into the auction for each of the CDS.

With respect to both (i) calculating the notional amount subject to the short notional amount threshold of $150 million by adding or subtracting the notional amount of any positions in a deliverable underlying debt security and (ii) calculating both the long and short $150 million notional amount thresholds by netting out the notional amount of any other Security Based Swap, specifically for single-name CDS where security-based swap would match the reference entity and the tenor, would reduce costs for market participants by potentially reducing the number of reports they would be required to file. However, these calculation methods would reduce the amount of information available to other market participants and, therefore, may not present the same counterparty risk reduction benefits.

7. Information Required To Be Reported on Schedule 10B

The Commission could propose that different information be reported on Schedule 10B. For example, the Commission could propose a version of Schedule 10B that would not require the public reporting of the identity of the filer. In this case, the market participant would inform the Commission about having exceeded the reporting threshold, but other market participants (counterparties, underlying reference entity, and other regulators) would not know or be able to identify the market participant that triggered the reporting obligation. This alternative would not allow market participants to know which counterparty they should change their behavior towards in order to reduce counterparty risk (for example, by adjusting prices to capture additional risk, increasing margin requirements, or decreasing trading activity). Market participants could treat all of their counterparties as if they exceeded the reporting threshold, potentially creating a chilling effect on the market. Accordingly, this alternative would not afford the same benefits of our proposed approach.

Alternatively, the Commission could propose that the rule require reporting the identity of the filer and not the underlying reference entity. Similarly, the Commission could propose the filer not to specify the size of the position, or information about the corresponding trading strategy. These alternatives would have the benefit of limiting the potential market reaction to the filer's trades and strategies, such as strategy replication or attempts to anticipate the filer's trading patterns. They would not, however, allow market participants to fully quantify nor understand the complete relationship the filer has with the underlying entity. This could cause an overreaction similar to the ones previously discussed, such as incentivizing counterparties to treat larger threshold breaches equally as smaller ones, or misinterpreting the strategy of the filer. Accordingly, the Commission does not believe that these alternatives would afford the same benefits of our proposed approach.

F. Request for Comment

The Commission requests comment on any aspect of the above economic analysis, including our description of the current economic baseline, the potential costs and benefits of the proposed amendments, their effect on efficiency, competition, and capital formation, and any reasonable alternatives we should consider. In addition, we request comment on the following aspects of the proposal:

• The Commission requests comment on the potential costs for security-based swap market participants, including costs attributable to the modification of market participants' business operations or supervisory practices or systems. The Commission also requests comments about any potential benefits resulting from the proposed Rule 9j–1, 10B–1, and 15Fh–4(c) for market participants and underlying entities. The

[268] For some underlying reference entities, it might be the case that there are significantly more CDS outstanding than bonds. Hence, the percent threshold could be greater than 100%.

[269] We provide an example of how a reporting entity might be able to ''hide'': The entity bought $300 million in CDS and simultaneously sold $300 million CDS, which yields a net exposure of zero and therefore no need to report under the net thresholds. When it becomes beneficial, the entity can relatively quickly obtain a directional net position of $300 million by selling either leg of the initial trade. This new position needs to be reported but the position is already in place and does not leave time for counterparties to adjust their positions in a timely manner.

Commission also seeks comments on the accuracy of any of the benefits identified and welcomes comments on any of the costs identified here. Finally, the Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits. The Commission seeks specific comment and empirical data, if available, on the potential impact of the proposed rule.

- We solicit comment on any additional short-term and long-term benefits that could be realized with re-proposed Rule 9j–1, proposed Rule 10B–1, and proposed Rule 15Fh–4(c). Specifically, we solicit comment regarding benefits to the efficient operation of the security-based swap market, price efficiency, market integrity, and investor protection.
- We request comment on whether re-proposed Rule 9j–1, proposed Rule 10B–1, or proposed Rule 15Fh–4(c) would promote efficiency, competition, and capital formation or have an impact or burden on competition both in the security-based swap market and the underlying markets. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.
- We solicit comment on costs associated with re-proposed Rule 9j–1, including whether the rule could discourage certain legitimate market activities, because of concern that such activities might be viewed as a violation of the rule. The Commission also requests specific comment on any changes to business operations or supervisory practices or systems that might be necessary to implement the proposed rule. In addition, the Commission solicits comment on any additional short-term and long-term costs that could result from proposed Rule 9j–1. Specifically, the Commission solicits comment regarding costs to the efficient operation of the security-based swap market, price efficiency, market integrity, and investor protection.
- The Commission solicits comment on the costs and benefits associated with the reporting thresholds for single-name CDS and TRS. Should these thresholds be lower or higher, and are there other alternative thresholds?
- The Commission solicits comment on the complexity of the reporting thresholds for single-name CDS, equity, and non-CDS security-based swaps. Should these thresholds be more complex, difficult to calculate, and precise, or simpler, easier to calculate, and broader, and are there other alternative thresholds?
- We solicit comment on costs associated with reporting of security-based swap positions as a result of proposed Rule 10B–1, including whether the rule would impose costs that could discourage market activity by creating indirectly position limits or liquidity pools.
- We solicit comment on any additional short-term and long-term benefits that could be realized with proposed Rule 10B–1. Specifically, the Commission solicits comment regarding benefits to the efficient operation of the security-based swap market, price efficiency, market integrity, and investor protection.
- The Commission solicits comment on benefits associated with reporting of security-based swap positions because of proposed Rule 10B–1, including whether the rule would give rise to additional benefits that could encourage capital formation for underlying entities. The Commission solicits comment on any long-term or short-term costs that might influence underlying entities because of reporting thresholds. How might underlying entities change funding practices or procedures under proposed Rule 10B–1?

VII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, (''SBREFA''),[270] the Commission requests comment on the potential effect of the proposed rules on the economy on an annual basis. The Commission also requests comment on any potential increases in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VIII. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act (''RFA'')[271] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a) of the Administrative Procedure Act,[272] 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 the impact of such rulemaking on ''small entities.''[273] 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.[274]

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;[275] 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) (''Rule 17a–5(d)'') under the Exchange Act,[276] 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.[277]

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 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

[270] Public Law 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C., and as a note to 5 U.S.C. 601).

[271] 5 U.S.C. 601 *et seq.*

[272] 5 U.S.C. 603(a).

[273] 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 proposed rulemaking, are set forth in 17 CFR 240.0–10 (''Rule 0–10'') under the Exchange Act. *See* Exchange Act Release No. 18452 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982) (File No. AS–305).

[274] *See* 5 U.S.C. 605(b).

[275] *See* 17 CFR 240.0–10(a).

[276] 17 CFR 240.17a–5(d).

[277] *See* 17 CFR 240.0–10(c).

''small entities'' for purposes of the RFA.

Although proposed Rule 15Fh–4(c) would apply only to SBS Entities, re-proposed Rule 9j–1 and proposed Rule 10B–1 (including proposed Schedule 10B) are not on their 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.[278] 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 re-proposed Rule 9j–1, even to the extent that a small number transactions did have a counterparty that was defined as a ''small entity'' under the Rule 0–10, the Commission believes it unlikely that the re-proposed 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. Finally, the Commission believes that the proposed reporting thresholds in proposed Rule 10B–1 are set sufficiently high as to further mitigate against the possibility of proposed Rule 10B–1 (including Schedule 10B) applying to persons who would be considered ''small entities'' under Rule 0–10.

For the foregoing reasons, the Commission certifies that proposed Rules 9j–1, 10B–1 (including Schedule 10B), and 15Fh–4(c), if adopted, would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission invites commenters to address whether the proposed rules would have a significant economic impact on a substantial number of small entities, and, if so, what would be the nature of any impact on small entities. The Commission requests that commenters provide empirical data to illustrate the extent of the impact.

IX. Statutory Authority

The Commission is proposing 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, 10B, 15, 15F, and 23(a) thereof (15 U.S.C. 78b, 78c(b), 78i(i), 78i(j), 78j, 78j–2, 78o, 78o–10, and 78w(a)).

[278] *See* 17 CFR 240.0–10(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 Proposed Rule

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

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

■ 1. The general authority citation for part 240 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, 78c3, 78c–5, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78j–2, 78k, 78k–1, 78*l,* 78m, 78n, 78n–1, 78o, 78o–4, 78o–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.

* * * * *

■ 2. Add § 240.9j–1 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 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; or

(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; or

(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 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;

(b) It shall be 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.

(c) 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.

(d) Whenever taking any of the actions set forth in paragraphs (a) or (b) 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 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 paragraphs (a) or (b) of this section.

(e) 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.

(f) A person shall not be liable under paragraph (a) of this section solely for reason of being aware of material non-public 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 security-based swap documentation governing such transaction or any amendment thereto) so long as:

(i) The security-based swap was entered into, or the amendment was made, before the person came into

possession of such material non-public information; and

(ii) The entry into, and the terms of, the security-based swap are themselves not a violation of any provision of this section.

(2) 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 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.

■ 3. Add an undesignated center heading and § 240.10B–1 to read as follows:

Requirements and Reports Under Section 10B

§ 240.10B–1 Reporting of Security-based Swap Positions.

(a) *Reporting obligation.*

(1) Any person (and any entity controlling, controlled by or under common control with such person), or group of persons, who through any contract, arrangement, understanding or relationship, after acquiring or selling directly or indirectly, any security-based swap, is directly or indirectly the owner or seller of a security-based swap position that exceeds the reporting threshold amount, shall file with the Commission a statement containing the information required by § 240.10B–101 (Schedule 10B) on the Commission's Electronic Data Gathering, Analysis and Retrieval System (EDGAR).

(2) Any Schedule 10B required by this section shall be filed promptly, but in no event later than the end of the first business day following the day of execution of the security-based swap transaction that results in the security-based swap position first exceeding the reporting threshold amount.

(3) A group's filing obligation pursuant to paragraph (a)(1) of this section may be satisfied either by a single joint filing or by each of the group's members making an individual filing. If the group's members elect to make their own filings, each such filing should identify all members of the group but the information provided concerning the other persons making the filing need only reflect information which the filing person knows or has reason to know.

(4) Any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device as part of a plan or scheme to evade the reporting requirements of paragraph (a)(1) of this section with respect to a security-based swap position shall be deemed for purposes of this section to be the owner of such security-based swap position.

(b) *Definitions.* For purposes of this section:

(1) The term *reporting threshold amount* shall mean:

(i) With respect to credit default swaps (including credit default swaps where the underlying reference is a group or index of entities or obligations of entities that is a narrow-based security index), the lesser of:

(A) A long notional amount of $150 million, calculated by subtracting the notional amount of any long positions in a deliverable debt security underlying a security-based swap included in the security-based swap position from the long notional amount of the security-based swap position;

(B) A short notional amount of $150 million; or

(C) A gross notional amount of $300 million.

(ii) With respect to security-based swap positions based on debt securities that are not credit default swaps, a gross notional amount of $300 million.

(iii) With respect to security-based swap positions based on equity securities, the lesser of:

(A) A gross notional amount of $300 million; *provided, however,* that if the gross notional amount of the security-based swap position exceeds $150 million, the calculation of the security-based swap position shall also include the value of all of the underlying equity securities owned by the holder of the security-based swap position (based on the most recent closing price of shares), as well as the delta-adjusted notional amount of any options, security futures, or any other derivative instruments based on the same class of equity securities; or

(B) A security-based swap equivalent position that represents more than 5% of a class of equity securities; *provided, however,* that if the security-based swap equivalent position represents more than 2.5% of a class of equity securities, the calculation of the security-based swap equivalent position shall also include in the numerator all of the underlying equity securities owned by the holder of the security-based swap position, as well as the number of shares attributable to any options, security futures, or any other derivative instruments based on the same class of equity securities.

(2) The term *security-based swap equivalent position* shall mean the number of shares attributable to all of the security-based swaps comprising a security-based swap position, as determined in accordance with paragraph (b)(4) of this section.

(3) The term s*ecurity-based swap position* shall mean all security-based swaps based on:

(i) A single security or loan, or a narrow-based security index, or any interest therein or based on the value thereof;

(ii) Any securities issued by the same issuer (each, an ''issuing entity'') the securities, loans, or securities included in the narrow-based index (including any interest therein or based on the value thereof) described in paragraph (b)(3)(i); or

(iii) Any narrow-based security index that includes any of those issuing entities or their securities (including any interest therein or based on the value thereof), in each case as applicable. To the extent that a security-based swap position is based on a single security or loan that is included in a narrow-based security index, the calculation of the security-based swap position with respect to a particular component of the index would be based on the weighting of the reference entity or securities as a component of the index. With respect to security-based swaps based on equity securities, a security-based swap position shall include all security-based swaps based on a single class of equity securities.

(4) When used in paragraphs (b)(1)(iii)(B) and (b)(2) of this section, the ''number of shares attributable'' to a derivative instrument (including a security-based swap) shall mean the *larger* of (in each case as applicable):

(i) The number of shares of the reference equity security that may be delivered upon on the exercise of the rights under the derivative instrument, as determined in accordance with the terms of the applicable documentation;

(ii) The number of shares of the reference equity security determined by multiplying the number of shares by reference to which the amount payable under the derivative instrument is determined by the delta of the applicable derivative instrument; and

(iii) The number of shares of the reference equity determined by:

(A) Dividing the notional amount of such derivative instrument by the most recent closing price of shares of the reference equity security; and then

(B) Multiplying such quotient by the delta of the applicable derivative instrument.

(5) For purposes of paragraph (b)(1)(i) of this section, a ''debt security underlying a security-based swap included in the security-based swap position'' means any security that could potentially be deliverable into a credit default swap auction in the event of a default.

(6) For purposes of paragraphs (b)(1)(iii)(A) and (b)(4) of this section, the term ''delta'' shall mean the ratio that that is obtained by comparing (x) the change in the value of a derivative instrument to (y) the change in the value of the reference equity security. If a derivative instrument does not have a fixed delta, then the delta should be calculated on a daily basis, based on the most recent closing price of shares of the reference equity security.

(7) For purposes of paragraph (b)(1)(iii)(A) and (B) of this section, a person that is a member of a national securities exchange shall not be deemed to be the owner of any equity securities that they hold directly or indirectly on behalf of another person solely because such person is the record holder of such securities and, pursuant to the rules of such exchange, may direct the vote of such securities, without instruction, on other than contested matters or matters that may affect substantially the rights or privileges of the holders of the securities to be voted, but is otherwise precluded by the rules of such exchange from voting without instruction.

(c) *Amendments.* If any material change occurs in the facts set forth in a previously filed Schedule 10B including, but not limited to, any material increase in the security-based swap positions or if a security-based swap position falls back below the applicable reporting threshold amount, the person or persons who were required to file the statement shall file or cause to be filed with the Commission an amendment disclosing that change. All such amendments shall be filed on EDGAR promptly, but in no event later than the end of the first business day following the material change. For purposes of this paragraph (c), a change equal to 10% or more of a position previously disclosed in Schedule 10B shall be deemed ''material'' for purposes of this section.

(d) *Applicability.* The requirements of this section shall apply to all security-based swap positions so long as:

(1) Any of the transactions that comprise the security-based swap position would be required to be reported pursuant to § 242.908(a) of this chapter (Rule 908 of Regulation SBSR); or

(2) The reporting person holds any amount of reference securities underlying the security-based swap position (or would be deemed to be the beneficial owner of such reference securities, pursuant to Section 13(d) of the Act (15 U.S.C. 78m) and the rules and regulations thereunder), *and:*

(i) The issuer of such reference security is a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the U.S. or having its principal place of business in the U.S.; or

(ii) Such reference security is part a class of securities registered under Section 12 or 15(d) of the Exchange Act.

(e) If some or all of the information required to be disclosed on Schedule 10B is publicly available on EDGAR at the time the Schedule 10B is required to be filed, such information may be incorporated by reference in answer, or partial answer, to any item of Schedule 10B.

■ 4. Add § 240.10B–101 to read as follows:

§ 240.10B–101 Schedule 10B—Information to be included in statements filed pursuant to § 240.10B–1(a) and amendments thereto filed pursuant to § 240.10B–1(c).

Securities and Exchange Commission, Washington, DC 20549 Schedule 10B Under the Securities Exchange Act of 1934 (Amendment No. __) * (Name, Address, Email Address and Telephone Number of Person Authorized To Receive Notices and Communications) (Date of Event Which Requires Filing of This Statement or Any Amendment Thereto As Required by Rule 10B–1(c))

(1) State the name of the reporting person (or names of reporting persons if making a joint filing as a group). State if the reporting person is a member of a group. If the reporting person is a member of a group and the members of the group are satisfying the group's Rule 10B–1(a)(1) (§ 240.10B–1(a)(1)) filing obligation by making individual filings, identify all members of the group.

(2) State the residency or place of organization of the reporting person(s).

(3) State the type of reporting person(s) (see instructions).

(4) For reporting persons that are legal entities, state the Legal Entity Identifier (LEI) of the reporting person(s), if such person(s) has an LEI.

(5) State the notional amount of the applicable security-based swap position(s), as defined in Rule 10B–1(b)(3) (§ 240.10B–1(b)(3)), of the reporting person(s), along with summary information about the composition of the position as it relates to the direction (*i.e.,* long or short) and the tenor/expiration of the underlying security-based swap transactions and the product ID (17 CFR 242.900(bb)) of the security-based swap(s) included in the security-based swap position, if applicable.

(6) In the case of a security-based swap position based on debt securities (including credit default swaps), state the ownership of: (i) All debt securities underlying a security-based swap included in the security-based swap position, including the Financial Instrument Global Identifier (FIGI) of each underlying debt security, if applicable, and the LEI of the issuer of each underlying debt security, if the issuer has an LEI; and (ii) all security-based swaps based on equity securities issued by the same reference entity, including the FIGI of each underlying equity security, if applicable. In addition to the FIGI, other unique security identifier(s) may be included at the filer's option.

(7) In the case of a security-based swap position based on equity securities, state the ownership of: (i) All equity securities underlying a security-based swap included in the security-based swap position, including the FIGI of each underlying equity security, if applicable, and the LEI of the issuer of each underlying equity security, if the issuer has an LEI; and (ii) all security-based swaps based on debt securities issued by the same reference entity (including credit default swaps), including the FIGI of each underlying debt security, if applicable. In addition to the FIGI, other unique security identifier(s) may be included at the filer's option.

(8) State the ownership of any other instrument relating to the security-based swap position and/or any underlying security or loan or group or index of securities or loans, or any security or group or index of securities, the price, yield, value, or volatility of which, or of which any interest therein, is the basis for a material term of a security-based swap included in the security-based swap position, if not otherwise disclosed pursuant to Items 6 or 7 of this statement. For any underlying security disclosed pursuant to this Item, disclose the FIGI of the security, if applicable, and the LEI of the issuer of the security, if the issuer has an LEI. In addition to the FIGI, other unique security identifier(s) may be included at the filer's option.

(9) To the extent that the reporting threshold amount, as defined in Rule 10B–1(b)(1) (§ 240.10B–1(b)(1)), is based on the number of shares corresponding to a security-based swap position based on equity securities, state the number of shares attributable to the security-based swap position, along with the closing price used in the calculation and the date of such closing price.

Instructions to Schedule 10B

(1) *Type of Reporting Person*—Please classify each ''reporting person'' according to the following breakdown and place the appropriate symbol (or symbols, *i.e.,* if more than one is

applicable, insert all applicable symbols) on the form:

Category	Symbol
Broker Dealer	BD
Security-Based Swap Dealer or Major Security-Based Swap Participant	SBSE
Bank	BK
Insurance Company	IC
Investment Company	IV
Investment Adviser	IA
Employee Benefit Plan or Endowment Fund	EP
Parent Holding Company/Control Person	HC
Savings Association	SA
Church Plan	CP
Corporation	CO
Partnership	PN
Individual	IN
Other	OO

(2) *Incorporation by Reference*—Rule 10B–1(e) (§ 240.10B–1(e)) provides that if some or all of the information required to be disclosed on Schedule 10B is publicly available on EDGAR at the time the Schedule 10B is required to be filed, such information may be incorporated by reference in answer, or partial answer, to any item of Schedule 10B. Include an express statement clearly describing the specific location of the information you are incorporating by reference. You must include an active hyperlink to information incorporated into Schedule 10B to the applicable link to EDGAR). The information must not be incorporated by reference in any case where such incorporation would render the disclosure incomplete, unclear, or confusing. For example, disclosure must not be incorporated by reference from a second document if that second document incorporates information pertinent to such disclosure by reference to a third document.

Signature. After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Date

Signature

Name/Title

The original statement shall be signed by each person on whose behalf the statement is filed or their authorized representative. If the statement is signed on behalf of a person by their authorized representative (other than an executive officer or general partner of the reporting person), evidence of the representative's authority to sign on behalf of such person shall be filed with the statement, provided however, that a power of attorney for this purpose which is already on file with the Commission may be incorporated by reference.

Attention—Intentional misstatements or omissions of fact constitute Federal criminal violations (See 18 U.S.C. 1001).

■ 5. Amend § 240.15Fh–4 by adding paragraph (c) to read as follows:

§ 240.15Fh–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.

* * * * *

(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: December 15, 2021.

Vanessa A. Countryman,

Secretary.

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