December 21, 2020

SEC Announces the Creation of the Security-Based Swaps Joint Venture

Joint Venture to Be Led by Division of Examinations and Division of Trading and Markets

SUMMARY

Beginning in November 2021, security-based swap dealers and major security-based swap participants will be required to register with the SEC and comply with various other regulations relating to capital, margin, segregation, and transaction reporting. The SEC has said it will exercise its regulatory authority, among other things, to monitor risk and to prevent fraud in the security-based swaps market.[1]

On December 18, 2020, in preparation for the November 2021 trigger date, the SEC announced the creation of the Security-Based Swaps Joint Venture, described as a collaborative venture among SEC divisions and offices responsible for coordinating functions related to the regulation of security-based swaps and oversight of certain entities that will be required to register with the SEC. [2]

The creation of this Joint Venture shows that the SEC is actively preparing to carry out its regulatory responsibilities over the security-based swaps market and will bring together all the relevant expertise within the agency to do so. In recent years, the CFTC has been active in the regulation and enforcement of the swaps market. The same is expected from the SEC, though the SEC has not yet identified its exact priorities in this area.

DISCUSSION

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") established a comprehensive framework for the regulation of over-the-counter swaps markets.[3] Under that framework, the SEC has authority to regulate the security-based swaps market, while the CFTC regulates most other types of swaps.

In December 2019, the SEC passed a final rule establishing the agency's security-based swaps regulatory regime, and setting registration and other compliance dates for security-based swap dealers and major security-based swap participants. Under these regulations, beginning in November 2021, security-based swap dealers and major security-based swap participants must register with the SEC and comply with rules related to capital, margin, segregation, and transaction reporting. The SEC will use the information provided by these new registrants to monitor the build-up and concentration of risk exposures, prevent fraud, supervise systemic risk, and resolve issues and positions after an institution fails.[4]

SEC Chairman Jay Clayton stated that enhancing coordination with the CFTC and other regulators would strengthen the SEC's ability to oversee the security-based swaps market, security-based swap dealers, and major security-based swap participants. Peter Driscoll, Director of the Division of Examinations, added that the Joint Venture would enable the SEC to identify key risks in the security-based swaps market and provide guidance to assist security-based swap dealers in managing those risks.[5]

The co-heads of the Security-Based Swap Joint Venture will be Vivi Mazarakis, an Acting Assistant Director in the Division of Examinations (formerly the Office of Compliance Inspections and Examinations), and Carol McGee, the Assistant Director for the Office of Derivatives Policy in the Division of Trading and Markets. Staff from across the SEC will participate, including staff from the Division of Enforcement, the Division of Economic Risk and Analysis, the Office of International Affairs, and the Office of the Chief Data Officer. The Joint Venture is designed to "ensur[e] that the Commission is prepared for the November 2021 deadline," stated Brett Redfearn, Director of the Division of Trading and Markets.[6]

IMPLICATIONS

The swaps markets are complex, and Dodd-Frank's mandate that large swaths of these markets be brought under the regulatory jurisdiction of the SEC and CFTC has presented market participants with a number of significant compliance challenges and important business decisions. This expanded regulatory jurisdiction has also yielded significant enforcement actions, which have resulted in substantial penalties and undertakings, including, in certain instances, requirements for independent consultants or monitors. Security-based swap dealers and major security-based swap participants that believe they may have an SEC registration obligation should be taking the necessary steps to prepare for the impending regulatory obligations and oversight.

Although the SEC is still in the early stages of its regulation of security-based swaps, the CFTC has actively regulated a wide range of swaps markets, including swaps related to commodities, currencies, and interest rates, since the passage of Dodd-Frank.[7] The SEC, moreover, has plainly stated that the Joint Venture will seek to "enhanc[e] coordination with the CFTC and other regulators" in the swaps markets.[8] Thus, in considering how the SEC might exercise its authority over the security-based swaps market, it may be informative to look to the CFTC's approach in regulating the swaps markets more generally.[9]

Of particular note, in recent years the CFTC has initiated a number of enforcement actions against swap dealers in many of the same areas identified by the SEC: namely, risk management and reporting obligations related to capital, margin, and segregation requirements, as well as in areas involving fraud and manipulation. For example, in June 2020 the CFTC resolved a 2016 federal court action it had filed in the Southern District of New York against a global bank for failure to meet its responsibilities regarding swap data reporting and supervision.[10] As part of that action, the bank agreed to pay a $9 million civil monetary penalty and consented to the appointment of an independent monitor to oversee its compliance with various specific undertakings and the regulatory regime more generally.[11]

Similarly, in 2018, the CFTC settled charges with another global bank in connection with transaction reporting and compliance inadequacies.[12] This enforcement action also included a false statement charge for misrepresentations contained in the bank's Chief Compliance Officer report that had previously been filed with the CFTC. As part of the settlement, the bank paid a $12 million civil monetary penalty and was required to undertake a number of affirmative remedial measures, including retaining an outside consultant to review its swap dealer compliance and submit to the CFTC annual certified reports regarding its swap dealer compliance.[13]

The CFTC has brought several other significant enforcement actions in the swaps markets it regulates, including one resulting in over $14 million in sanctions against a U.S. bank for violating swap dealer business conduct standards,[14] one charging an executive at a global investment bank with manipulation and fraud in connection with swaps used to price a bond issuance,[15] one against the U.S. subsidiary of a global bank for failing to establish appropriate risk management systems,[16] and multiple actions against financial institutions for manipulating interest rate swaps benchmarks with penalties reaching into the hundreds of millions of dollars.[17]

As the SEC proceeds to carry out its regulatory responsibilities, the CFTC's past regulatory experience might provide a roadmap, particularly given the coordination between the SEC and CFTC in this area. Thus, one can expect the SEC to actively regulate—and to enforce—the obligations of registrants and other market participants in the security-based swaps market. Accordingly, market participants who believe they may be subject to these regulatory obligations should ensure they are prepared for the regulatory obligations and oversight to come.

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ENDNOTES

[1] Press Release, SEC Announces the Creation of the Security-Based Swaps Joint Venture, Led by Division of Examinations and Division of Trading and Markets (Dec. 18, 2020), https://www.sec.gov/news/press-release/2020-323.

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *See, e.g.*, Cross-border Margin Rule, 17 C.F.R. § 23.160 (2020).

[8] Press Release, SEC Announces the Creation of the Security-Based Swaps Joint Venture, Led by Division of Examinations and Division of Trading and Markets (Dec. 18, 2020), https://www.sec.gov/news/press-release/2020-323.

[9] *See, e.g.*, Press Release, At Joint Open Meeting, CFTC and SEC Approve Final Rule on Security Futures Margin and Request for Comment on Portfolio Margining (Oct. 22, 2020), https://www.sec.gov/news/press-release/2020-264 ("'The markets the CFTC and SEC regulate are highly interconnected, so coordination is vital to regulatory effectiveness. The historic joint open meeting of our two agencies reflects our strong commitment to cooperation and harmonizing our efforts where appropriate,' said CFTC Chairman Heath P. Tarbert. . . . 'I am pleased that the Commissions will continue this collaboration to examine potential ways to implement the portfolio margining of uncleared swaps and non-cleared security-based swaps.'").

[10] Consent Order 1, *CFTC* v. *Deutsche Bank AG*, No. 16-cv-6544, 2020 WL 4611985, at *1 (S.D.N.Y. June 17, 2020), ECF No. 14.

[11] *Id.* at 20–21, 2020 WL 4611985, at *10.

[12] Order 2, *In re Commerzbank AG*, CFTC No. 19-03, 2018 WL 5921385, at *1–2 (Nov. 8, 2018).

[13] *Id.* at 17–19, 2018 WL 5921385, at *15–17. The CFTC has brought several other cases against swap dealers for failing to report transactions accurately, several of which have involved failure-to-supervise charges as well. *See, e.g.*, Order 2, *In re Société Générale Int'l Ltd.*, CFTC No. 19-38, 2019 WL 4915485, at *1–2 (Sept. 30, 2019).

[14] Order 4–6, *In re Wells Fargo Bank, N.A.*, CFTC No. 20-08, 2019 WL 6003221, at *4–5 (Nov. 8, 2019).

[15] Complaint ¶¶ 129–137, *CFTC* v. *Christopher Rivoire*, 19-cv-11701 (S.D.N.Y. Dec. 20, 2019), ECF No. 1.

[16] Order 6–7, *In re HSBC Bank USA, N.A.*, CFTC No. 19-41, 2019 WL 4915488, at *5–6 (Sept. 30, 2019).

[17] *See, e.g.*, Order 2, 20, *In re Citibank, N.A.*, CFTC No. 16-16, 2016 WL 3035030, at *1–2, *18 (May 25, 2016).

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