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SEC Chair Gensler Highlights Upcoming Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants

SEC Chair Gary Gensler's Remarks Before ABA Committee Remind Market Participants of Upcoming Regulatory Changes for Security-Based Swap Dealers and Major Security-Based Swap Participants

SUMMARY

In remarks before the American Bar Association's ("ABA") Derivatives and Futures Law Committee, Securities and Exchange Commission ("SEC") Chair Gary Gensler highlighted the upcoming compliance dates for rules under which security-based swap dealers ("SBSDs") and major security-based swap participants ("major SBSPs"; and, together with SBSDs, "SBS Entities") will have to register with the SEC and comply with SEC rules applicable to SBSDs. Recent guidance provides that affected market participants should assess whether they meet the relevant thresholds to register as an SBSD or a major SBSP with the SEC. In particular, a person whose dealing activity in security-based swaps engaged in on or after August 6, 2021 exceeds the *de minimis* threshold will be required to register with the SEC as an SBSD by November 1, 2021. However, once a person meets the definition of an SBSD by exceeding the *de minimis* threshold, a transitional period, running until two months after the end of the month in which the person crosses the *de minimis* threshold, applies before the person must register and comply with the SBSD rules. Other market participants that, as a result of their security-based swap activities as of September 30, 2021, meet the major SBSP definition by exceeding the *de minimis* threshold, must register with the SEC by December 1, 2021. However, similar to the transitional period afforded to SBSDs, a person who meets the definition of a major SBSP by exceeding the *de minimis* threshold is also granted a transitional period before it is required to register and comply with the applicable rules, running from two

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months after the end of the quarter in which the person's activities cross the *de minimis* threshold. In addition, both SBSDs and major SBSPs must also comply with certain other rules by October 6, 2021, as described below.

A. CHAIR GENSLER'S REMARKS

SEC Chair Gary Gensler provided the keynote address at the ABA's Derivatives and Futures Law Committee as part of its mid-year program.¹ Chair Gensler's remarks focused primarily on the regulation of the security-based swaps market and security-based swap execution facilities.² Among other topics, Chair Gensler discussed the new requirements under which SBSDs and major SBSPs will be required to register with the SEC before the end of 2021, which are described in more detail below.³ Chair Gensler also noted that the SEC has made a substituted compliance determination order with respect to certain key back-office controls for German firms with a prudential regulator and that the SEC expects to receive and review substituted compliance applications for additional jurisdictions soon.⁴

B. OVERVIEW OF REGISTRATION REQUIREMENTS

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act established a comprehensive framework for the regulation of over-the-counter swaps markets.⁵ Under that framework, the SEC regulates the security-based swaps market, while the Commodity Futures Trading Commission regulates other types of swaps.

In December 2019, the SEC promulgated a final rule regarding its security-based swaps regulatory regime, which set registration and other compliance dates for SBSDs and major SBSPs (the "Final Rule").⁶ Under the Final Rule, SBSDs and major SBSPs must register with the SEC and comply with rules related to capital, margin, segregation, and transaction reporting. The SEC notes that it 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 should an institution fail.⁷

Recent guidance issued by the SEC's Division of Trading and Markets (the "Division") notes that market participants should assess whether they meet the relevant thresholds to register as an SBSD or a major SBSP with the SEC,⁸ and observes that August 6, 2021 (the "Counting Date") is the date from which security-based swap positions began to be counted for purposes of a person's determination of its status as an SBSD or a major SBSP subject to registration.⁹ To the extent that a person's status as an SBS Entity is based on a test that requires the person to look back over a period of time, no transactions entered prior to the Counting Date will "count" for the purposes of the relevant test.

For swap dealers, dealing activity connected to security-based swap positions engaged in on or after the Counting Date will count with respect to whether a swap dealer is required to register as an SBSD with the SEC. According to the Division's guidance, swap dealers whose activity is below the *de minimis* threshold,

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meaning that the aggregated gross notional amount of their security-based swap positions connected with their security-based swap dealing activity over a certain period of time falls below certain amounts, will generally not be required to register with the SEC by November 1, 2021, the registration date for SBSBs (the “Registration Date”).¹⁰ Broadly speaking, the threshold amounts are \$3 billion, subject to a phase-in of no more than \$8 billion, for credit default swaps and \$150 million, subject to a phase-in of no more than \$400 million, for other swaps.¹¹ As of now, swap dealers may rely on the phase-in thresholds of \$8 billion for credit default swaps and \$400 million for other swaps, as the SEC has not yet announced when the phase-in period will end.¹² Further, since no transactions entered into prior to the Counting Date “count” for purposes of tests such as the *de minimis* test, a person need not consider a full year’s worth of countable positions until one year after the Counting Date (August 6, 2022).¹³ Nonetheless, the SEC has stated that it expects that some larger SBSBs will need to register as of the Registration Date, despite the fact that this year’s counting period is significantly abbreviated.¹⁴ In addition, according to the Division, transactions entered into between a non-U.S. person and a foreign branch of a U.S. unregistered SBSB will not count toward the *de minimis* thresholds until December 31, 2021.¹⁵

In a similar vein, for other market participants, only security-based swap positions held on and after the Counting Date will count with respect to whether they are required to register as major SBSPs. Market participants that, as a result of security-based swap activities as of September 30, 2021 (less than two months after the Counting Date), meet the major SBSP definition by exceeding the *de minimis* threshold must register with the SEC by December 1, 2021 (unless otherwise registered with the SEC as an SBSB).¹⁶

However, the requirements of the Final Rule do not apply immediately to a market participant when it meets the relevant activity thresholds; instead, there is a transitional period of at least two months before any market participant is deemed to be an SBSB or major SBSP and required to register with the SEC and comply with the associated rules. For SBSBs, the transitional period runs until two months after the end of the month in which the swap dealer exceeds the *de minimis* threshold (or, if earlier, the date on which it applies for registration).¹⁷ Accordingly, a person whose swaps activity exceeded the *de minimis* threshold at any point between August 6 and August 31, 2021 (the Counting Date and the end of the month) will be required to comply with the rules applicable to SBSBs and to register with the SEC on November 1, 2021. If a person meets the definition of an SBSB by exceeding the *de minimis* threshold during the month of September 2021, it will not be required to adhere to the SBSB-related rules and register with the SEC until December 1, 2021. For other market participants, however, the transitional period runs until two months after the end of the quarter in which its security-based swap activities would cause it to meet the definition of major SBSP (or the date it applies for registration, whichever comes first).¹⁸ Accordingly, a person whose security-based swap activities in the quarter ending September 30, 2021 (counting only security-based swap activities from the Counting Date through September 30, 2021) cause it to meet the definition of a

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major SBSP by exceeding the *de minimis* threshold will not be required to comply with the rules applicable to major SBSPs and to register with the SEC until December 1, 2021.

In addition to the Counting Date and registration deadlines, market participants should also note that October 6, 2021 marks the earliest compliance date for other rules applicable to SBSDs and major SBSPs.¹⁹ Such rules include the following:²⁰

- capital and margin requirements;²¹
- segregation requirements for SBSDs, and related notification requirements, pursuant to which the money, securities, and property of a security-based swap customer relating to margin on cleared and non-cleared security-based swaps must be segregated;²²
- recordkeeping, reporting and notification requirements;²³
- securities count requirements for stand-alone SBSDs, which is modeled on the securities count program for broker-dealers, with some exceptions. Like the securities count program for broker-dealers, the new requirements for stand-alone SBSDs include a mandatory securities count each quarter, meaning that stand-alone SBSDs must, on a quarterly basis, examine and count the securities they physically hold, account for the securities that are not in their physical possession, verify the locations of securities under certain circumstances, and compare the results of the count and verification with their records;²⁴
- business conduct standards, including, among other things, the designation of a chief compliance officer;²⁵
- a requirement to provide and verify trade acknowledgments – that is, a written or electronic record of a security-based swap transaction sent by one counterparty to the other – in security-based swap transactions, so that SBS Entities can better measure and manage their market credit and risk;²⁶ and
- risk mitigation obligations, including reconciling outstanding security-based swaps with applicable counterparties on a periodic basis, engaging in certain forms of portfolio compression exercises, 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.²⁷

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ENDNOTES

¹ American Bar Association, *ABA Business Law Section Derivatives & Futures Law Committee Virtual Mid-Year Program* (July 14, 2021), <https://www.americanbar.org/content/dam/aba/administrative/cle/cl2101dafg2.pdf>.

² Gary Gensler, *Prepared Remarks of Gary Gensler, Chair of the Securities and Exchange Commission, Before the American Bar Association Derivatives and Futures Law Committee Virtual Mid-Year Program*, Securities and Exchange Commission (July 21, 2021), <https://www.sec.gov/news/speech/gensler-remarks-aba-derivatives-futures-law-committee-virtual-mid-year-program-072121>.

³ *Id.*

⁴ *Id.* In addition, on August 5, 2021, the Division issued a no-action letter, in response to a joint request from the International Swaps and Derivatives Association (“ISDA”) and the Securities Industry and Financial Markets Association (“SIFMA”), stating that it would not recommend an enforcement action with respect to certain regulations during the initial implementation period of the SEC’s rules for SBSDs and major SBSPs. See Securities and Exchange Commission, *Initial Implementation of Certain Security-Based Swap Dealer Rules* (August 5, 2021), <https://www.sec.gov/files/sifma-isda-08052021.pdf>. On the same day, the Division also granted ISDA and SIFMA’s joint request for no-action against nonbank SBSDs that do not collect initial margin from small counterparties before September 1, 2022. See Securities and Exchange Commission, *Request for No-Action Position under Exchange Act Rule 18a-2 Regarding Collecting Initial Margin from Small Counterparties* (August 5, 2021), <https://www.sec.gov/files/sifma-isda-18a-3-08052021.pdf>.

⁵ Securities and Exchange Commission, *SEC Announces the Creation of the Security-Based Swaps Joint Venture, Led by Division of Examinations and Division of Trading and Markets* (December 18, 2020), <https://www.sec.gov/news/press-release/2020-323>; Sullivan & Cromwell LLP, *SEC Announces the Creation of the Security-Based Swaps Joint Venture* (December 21, 2020), <https://www.sullcrom.com/files/upload/sc-publication-sec-announces-creation-security-based-swaps-joint-venture.pdf>.

⁶ See Cross-Border Application of Certain Security-Based Swap Requirements, 85 Fed. Reg. 6,270 (December 18, 2019) (“Final Rule”).

⁷ Securities and Exchange Commission, *supra* note 5.

⁸ Securities and Exchange Commission, *Key Dates for Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants*, <https://www.sec.gov/page/key-dates-registration-security-based-swap-dealers-and-major-security-based-swap-participants>.

⁹ *Id.*; see also Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, 80 Fed. Reg. 48,963 (August 14, 2015) (“SBS Entity Registration Adopting Release”); Final Rule, *supra* note 6. According to the Final Rule, the Registration Compliance Date is October 6, 2021, 18 months after the Effective Date of the Final Rule (April 6, 2020). According to the SBS Entity Registration Adopting Release, the Counting Date occurs two months before the Registration Compliance Date (August 6, 2021).

¹⁰ Securities and Exchange Commission, *supra* note 8.

¹¹ 17 C.F.R. § 240.3a71-2.

¹² *Id.*

¹³ SBS Entity Registration Adopting Release, *supra* note 9.

¹⁴ *Id.*

¹⁵ Securities and Exchange Commission, *supra* note 8.

¹⁶ *Id.*; see also Final Rule, *supra* note 6.

ENDNOTES (CONTINUED)

¹⁷ Securities and Exchange Commission, *supra* note 8; *see also* 17 C.F.R. § 240.3a71-2(b) (a person who exceeds the *de minimis* threshold receives a transitional period of at least two months before the person is deemed to be an SBSD).

¹⁸ Securities and Exchange Commission, *supra* note 8; *see also* 17 C.F.R. § 240.3a67-8(a) (a person who exceeds the *de minimis* threshold receives a transitional period of at least two months before the person is deemed to be a major SBSP).

¹⁹ Securities and Exchange Commission, *supra* note 8.

²⁰ Securities and Exchange Commission, *supra* note 8.

²¹ *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, 84 Fed. Reg. 43,872 (August 22, 2019).

²² *Id.*

²³ *See* Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers, 84 Fed. Reg. 68,550 (December 16, 2019).

²⁴ *Id.*

²⁵ *See* Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 81 Fed. Reg. 29,959 (May 13, 2016).

²⁶ *See* Trade Acknowledgment and Verification of Security-Based Swap Transactions, 81 Fed. Reg. 39,807 (June 17, 2016).

²⁷ *See* Risk Mitigation Techniques for Uncleared Security-Based Swaps, 85 Fed. Reg. 6,539 (February 4, 2020).

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