

September 22, 2014

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SEC Proposes Rule Regarding the Securities Act Treatment of Security-Based Swap Pricing Information on Certain Execution Facilities

On September 8, 2014, the U.S. Securities and Exchange Commission (the “SEC”) proposed a rule under the Securities Act of 1933 (“**Securities Act**”) providing that communications regarding pricing information on certain execution facilities for security-based swaps (“**SBSs**”) that may be purchased only by eligible contract participants (“**ECPs**”) would not be deemed to constitute offers of such SBSs for purposes of Section 5 of the Securities Act (“**Proposal**”).¹ Comments on the Proposal are due by November 10, 2014.

Background

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Title VII**”) amended the definitions of “security” in the Securities Act and the Securities Exchange Act of 1934 (“**Exchange Act**”) to include SBSs. As a result, SBSs are subject to the provisions of the Securities Act and the Exchange Act and the rules and regulations thereunder applicable to securities.

The Securities Act requires that any offer or sale of a security must either be registered under the Securities Act or be made pursuant to an exemption from registration. As a result, counterparties entering into SBS transactions need to rely on an available exemption from the registration requirements of the Securities Act or register such transactions.² Title VII also amended the Securities Act to require that SBS transactions involving persons who are not ECPs must be registered under the Securities Act.³

¹ Treatment of Certain Communications Involving Security-Based Swaps That May Be Purchased Only by Eligible Contract Participants, Release No. 33-9643 (Sept. 8, 2014), 79 Fed. Reg. 54224 (Sept. 11, 2014), *available at*: <http://www.gpo.gov/fdsys/pkg/FR-2014-09-11/pdf/2014-21676.pdf>.

² For example, Section 4(a)(2) of the Securities Act (formerly Section 4(2)) exempts transactions by an issuer not involving any public offering from the registration requirements of Section 5 of the Securities Act.

³ See Section 5(d) of the Securities Act, as added by Section 768(b) of Title VII.

In addition, Title VII requires certain SBSs to be traded on regulated trading platforms or exchanges.⁴ Title VII also requires any facility for trading or processing SBSs to register as a security-based swap execution facility (“**SB SEF**”) or as a national securities exchange.⁵ Title VII also amended the Exchange Act to add various new statutory provisions to govern the regulation of SB SEFs, including provisions relating to who may access such trading platforms (known as an “impartial access requirement”) and the availability of bid, offer, or other price information regarding SBSs traded on such platforms.⁶

Overview of the Proposal

Under the proposed rule, the publication or distribution of price quotes relating to SBSs that (i) may be purchased only by persons who are ECPs and (ii) are traded or processed on or through a facility that is registered as either a national securities exchange or an SB SEF, or is exempt from such registration, would not be deemed to constitute an offer, an offer to sell, or a solicitation of an offer to buy or purchase such SBSs for purposes of Section 5 of the Securities Act.⁷ The Proposal applies with respect to SBS price quotes, which the Proposal indicates could take a number of forms depending on the type of trading platform model, including indicative quotes, executable quotes, bids and offers, and other pricing information and other types of quote information that may develop in the future.⁸ It is not necessary for the transactions to be subsequently cleared through an eligible clearing agency.⁹

⁴ See Section 3C(h) of the Exchange Act, as added by Section 763(a) of Title VII.

⁵ See Section 3D(a)(1) of the Exchange Act, as added by Section 763(c) of Title VII. The SEC has taken the position that this requirement applies only to a facility that meets the definition of “security-based swap execution facility” in Section 3(a)(77) of the Exchange Act. See Proposal at 54225 n.20; see also Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-63825 (Feb. 2, 2011) 76 Fed. Reg. 10948, 10959 n.62 (Feb. 28, 2011) (“**SB SEF Proposal**”), available at: <http://www.gpo.gov/fdsys/pkg/FR-2011-02-28/pdf/2011-2696.pdf>.

⁶ See SB SEF Proposal.

⁷ The Proposal also provides that communications involving SBSs that may be purchased only by ECPs would not be deemed to constitute offers of any guarantees of such SBSs that are securities for purposes of Section 5 of the Securities Act. A guarantee of a security is itself a security for purposes of Section 2(a)(1) the Securities Act. See Proposal at 54228; see also Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48208, 48227 (Aug. 13, 2012), available at: <http://www.gpo.gov/fdsys/pkg/FR-2012-08-13/pdf/2012-18003.pdf>. The Proposal does not address whether a type of SBS would be a “class” for purposes of Section 12(g) of the Exchange Act or provide a broad-based exemption from Section 304(d) of the Trust Indenture Act of 1939 (“**Trust Indenture Act**”).

⁸ The Proposal notes that SBS transactions entered into solely between ECPs will be subject to the comprehensive regulatory regime of Title VII once it has been fully implemented, including the SEC’s proposed business conduct standards applicable to security-based swap dealers, regardless of whether SBS price quotes relating to such transactions are available on an unrestricted basis. See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Release No. 34-64766 (Jun. 29,

The Proposal was prompted, in part, by concerns raised by commenters that following the full implementation of Title VII, SB SEFs and national securities exchanges may require the publication or distribution of quotes for SBSs to all their participants and that participants in these platforms may be permitted to further disseminate such quotes, including through on-line information services, without restriction, depending on the rules of these platforms. As a result, such quotes may be available to any person on an unrestricted basis, including in some cases to non-ECPs.

In the SEC's view, the publication or distribution of price quotes for SBSs that are traded or processed on or through trading platforms *could be viewed* as offers of those SBSs within the meaning of the Securities Act. If considered offers, the publication or distribution of SBS price quotes may affect the availability of exemptions from the registration requirements of the Securities Act, including the exemption in Section 4(a)(2). They also may be subject to registration as offers of SBSs to non-ECPs.¹⁰

In order not to cause unintended consequences for the operation of eligible trading platforms and the ability of market participants to rely on available exemptions from the registration requirements of the Securities Act, the Proposal would allow such communications to be made without being considered offers for purposes of Section 5 of the Securities Act. The proposed relief would apply to the initial publication or distribution of the SBS price quotes on eligible trading platforms, as well as any subsequent republication or redistribution of the SBS price quotes on or through mediums other than eligible trading platforms, including on-line information services. However, the proposed rule would not otherwise affect the provisions of any exemptions from the registration requirements of the Securities Act.

The Proposal relates solely to the treatment of certain communications involving price quotes as offers for purposes of Section 5 of the Securities Act.¹¹ It does not address the availability of Securities Act exemptions for other published communications, although some commenters had expressed concerns about the effect on the availability of Securities Act exemptions arising from the publication of research reports on SBSs. However, the Proposal requests comment on whether broader

2011), 76 Fed. Reg. 42396 (Jul. 18, 2011), available at: <http://www.gpo.gov/fdsys/pkg/FR-2011-07-18/pdf/2011-16758.pdf>.

⁹ In March 2012, the SEC adopted an exemption from the Securities Act (other than the Section 17(a) antifraud provisions), the Exchange Act registration requirements, and provisions of the Trust Indenture Act for SBSs issued by eligible clearing agencies, subject to certain conditions. See Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies, Release No. 33-9308 (Mar. 30, 2012), 77 Fed. Reg. 20536 (Apr. 5, 2012), available at: <http://www.gpo.gov/fdsys/pkg/FR-2012-04-05/pdf/2012-8141.pdf>.

¹⁰ See note 3, *supra*.

¹¹ The Proposal does not limit in any way the scope or applicability of the antifraud or other provisions of the federal securities laws, including Section 17(a) of the Securities Act, relating to both oral and written material misstatements and omissions in the offer and sale of securities, including SBSs.

exemptions would be appropriate. The Proposal also states that SEC staff is evaluating the feasibility of a simplified disclosure and registration scheme for SBSs issued by registered or exempt clearing agencies that may be offered and sold to persons who are not ECPs.¹²

Relationship with Previous Exemptive Relief

To address registration issues under the Securities Act, the SEC previously adopted interim final exemptions to exempt offers and sales of “security-based swap agreements”¹³ that became SBSs on the Title VII effective date¹⁴ from all provisions of the Securities Act, other than the Section 17(a) antifraud provisions, as well as from the Exchange Act registration requirements, and from the provisions of the Trust Indenture Act, provided they are entered into between ECPs (as defined prior to the Title VII effective date) (“**Interim Final Exemptions**”).¹⁵

The Proposal is narrower than the Interim Final Exemptions because it only addresses the publication or distribution of price quotes arising from SBSs traded on a securities exchange or SB SEF. It does not provide a general exemption from the Securities Act, the Exchange Act registration requirements, or the Trust Indenture Act. As a result, under the Proposal, market participants still would need to make a determination as to whether an exemption from the registration provisions of the Securities Act is available with respect to an SBS transaction.

The SEC has extended the expiration date of the Interim Final Exemptions until February 11, 2017.¹⁶ However, the SEC indicated that if it adopts rules under the

¹² See note 9, *supra*. The Proposal states that certain market participants could reduce the registration burden for SBSs by using the Form S-3 shelf registration statement for their securities offerings. See Proposal at 54239 n.118.

¹³ For purposes of this relief, the term “security-based swap agreement” is defined in Section 2A of the Securities Act as in effect prior to July 16, 2011. This definition of “security-based swap agreement” is based upon the definition of “swap agreement,” which requires that the transaction be “subject to individual negotiation” and be between ECPs.

¹⁴ The definition of “security-based swap agreement” does not include SBSs that are based on or reference only loans or indices comprised only of loans. The SEC’s Division of Corporation Finance issued a no-action letter that addressed the availability of the relief for offers and sales of SBSs that are based on or reference only loans or indices comprised only of loans. See Cleary Gottlieb Steen & Hamilton LLP (Jul. 15, 2011), *available at*: <http://www.sec.gov/divisions/corpfin/cf-noaction/2011/clearygottliebsteenhamilton-071511-sec5.htm>. This no-action letter will remain in effect for so long as the interim final exemptions remain in effect.

¹⁵ Exemptions for Security-Based Swaps, Release No. 33-9231 (July 1, 2011), 76 FR 40605 (July 11, 2011), *available at*: <http://www.gpo.gov/fdsys/pkg/FR-2011-07-11/pdf/2011-17039.pdf>.

¹⁶ Extension of Exemptions for Security-Based Swaps, Release No. 33-9545 (Feb. 5, 2014), 79 Fed. Reg. 7570 (Feb. 10, 2014), *available at*: <http://www.gpo.gov/fdsys/pkg/FR-2014-02-10/pdf/2014-02833.pdf>.

Proposal, it may determine to alter the expiration dates in the Interim Final Exemptions, including possibly shortening the expiration dates.¹⁷

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¹⁷ The SEC also has granted temporary exemptions under the Exchange Act in connection with the revision of the definition of “security” to encompass SBSs. See Release No. 34-64795 (July 1, 2011), 76 Fed. Reg. 39927 (July 7, 2011), *available at*: <http://www.gpo.gov/fdsys/pkg/FR-2011-07-07/pdf/2011-17040.pdf>. Among other things, this exemptive order provided a temporary exemption from Sections 5 and 6 of the Exchange Act until the earliest compliance date set forth in any of the final rules regarding registration of SB SEFs. See notes 5 and 6, *supra*. The SEC extended these temporary exemptions until February 11, 2017. See Release No. 34-71485 (Feb. 5, 2014), 79 Fed. Reg. 7731 (Feb. 10, 2014), *available at*: <http://www.gpo.gov/fdsys/pkg/FR-2014-02-10/pdf/2014-02834.pdf>.

Office Locations

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS

12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS

Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON

City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW

Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT

Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE

Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME

Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN

Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG

Cleary Gottlieb Steen & Hamilton (Hong Kong)
Hysan Place, 37th Floor
500 Hennessy Road
Causeway Bay
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING

Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES

CGSH International Legal Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO

Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299

ABU DHABI

Al Sila Tower, 27th Floor
Sowwah Square, PO Box 29920
Abu Dhabi, United Arab Emirates
T: +971 2 412 1700
F: +971 2 412 1899

SEOUL

Cleary Gottlieb Steen & Hamilton LLP
Foreign Legal Consultant Office
19F, Ferrum Tower
19, Eulji-ro 5-gil, Jung-gu
Seoul 100-210, Korea
T: +82 2 6353 8000
F: +82 2 6353 8099