



Commodity Futures Trading Commission

Office of Public Affairs

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Final Rules Regarding Business Conduct Standards for Swap Dealers and Major Swap Participants Dealing with Counterparties

The Commodity Futures Trading Commission (Commission) is adopting final business conduct standards rules for swap dealers and major swap participants dealing with counterparties.

Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

The Dodd-Frank Act adds Section 4s(h) to the Commodity Exchange Act (CEA), which requires the Commission to adopt business conduct standards rules for swap dealers (SDs) and major swap participants (MSPs and collectively SDs/MSPs) governing their dealings with counterparties generally, and additional requirements when they deal with “Special Entities.” Under the final rules, Special Entities are governmental entities; employee benefit plans subject to Title I of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) (ERISA); governmental plans defined in Section 3 of ERISA; any other employee benefit plan defined in ERISA that elects to be a Special Entity; and any endowment.

The Commission’s final rules apply to SDs and (except where indicated) MSPs and prohibit certain abusive practices, require disclosures of material information to counterparties and require SDs/MSPs to undertake certain due diligence relating to their dealings with counterparties. Certain rules do not apply to transactions initiated on a swap execution facility (SEF) or designated contract market (DCM) when the SD/MSP does not know the identity of the counterparty prior to execution.

General provisions and requirements

- Definitions
- Policies and procedures to ensure compliance and prevent evasion of the CEA and Commission rules
- “Know your counterparty” (only for SDs)
- Rules relating to means of compliance
- Recordkeeping requirements

Prohibition on fraud, manipulation and other abusive practices

- Prohibition against fraudulent, deceptive, and manipulative acts or practices, including an affirmative defense to non-scienter fraud violations based on good faith compliance with policies and procedures
- Confidential treatment of counterparty information is required

Swap dealer and major swap participant duties to all counterparties

Verification – Duty to verify that a counterparty is an eligible contract participant and whether a counterparty is a Special Entity; includes a safe harbor based on specified counterparty representations

Disclosure of material information – in a manner sufficient to allow the counterparty to assess:

- Material risks
- Material characteristics
- Material incentives and conflicts of interest

Daily Mark – Duty to provide the daily mid-market mark for uncleared swaps to the counterparty

Clearing Disclosures – Duty to notify a counterparty of its right (1) to clear a swap that is not required to be cleared and (2) to select the derivatives clearing organization

Communications-Fair Dealing – Duty to communicate with counterparties in a fair and balanced manner based on principles of fair dealing and good faith

Swap dealer duties to all counterparties

Scenario analysis – Counterparties may elect to receive scenario analysis from an SD for swaps that are not made available for trading on a SEF or DCM

Institutional suitability – Duty to understand risks and rewards of a recommended swap and to have a reasonable basis to believe that a recommended swap is suitable for the counterparty

- Safe harbor – SD will be deemed to satisfy its duty to have a reasonable basis to believe that a recommended swap is suitable for the counterparty if it exchanges specified representations with the counterparty or the counterparty’s agent

Swap dealers acting as advisors to Special Entities

Duty for SD that “acts as an advisor to a Special Entity” to act in the best interests of the Special Entity

SD “acts as an advisor to a Special Entity” when it recommends a swap or swap trading strategy tailored to the needs or characteristics of the Special Entity.

Safe harbor

- For ERISA plans: the ERISA plan represents that it has an ERISA fiduciary; the ERISA fiduciary represents that it does not rely on SD’s recommendations; and the ERISA plan has policies and procedures ensuring any recommendation the Special Entity receives from the SD materially affecting a swap transaction is evaluated by a fiduciary before the transaction occurs, or that any recommendation the Special Entity has received from the SD materially affecting a swap transaction was evaluated by a fiduciary before that transaction occurred.
- For any Special Entity (including ERISA plans): the SD does not express an opinion as to whether the Special Entity should enter into a recommended swap that is tailored to the particular needs or characteristics of the Special Entity; Special Entity represents that it will not rely on SD and will rely on advice of its independent representative; and SD discloses that it is not acting in Special Entity’s best interests.

Swap dealers and major swap participants acting as counterparties to Special Entities

SDs/MSPs must have a reasonable basis to believe that a Special Entity (other than an ERISA plan) has a “representative” that meets the following criteria:

- is sufficiently knowledgeable to evaluate the transaction and risks;
- is not subject to statutory disqualification;
- is independent of the SD/MSP;

- acts in the best interests of the Special Entity;
- makes appropriate and timely disclosures to the Special Entity;
- evaluates, consistent with any guidelines provided by the Special Entity, fair pricing and appropriateness of the swap; and
- in the case of a governmental Special Entity, is subject to restrictions on certain political contributions to public officials of the governmental Special Entity

For ERISA plans, SD/MSP must have a reasonable basis to believe an ERISA plan’s “representative” is an ERISA fiduciary

When entering into a swap with Special Entity, SD/MSP must disclose to the Special Entity the capacity in which it is acting

Safe harbor: SD/MSP will be deemed to have a reasonable basis to believe that a Special Entity has a qualified independent representative if:

- For ERISA plans, the ERISA plan represents that its representative is an ERISA fiduciary
- For other Special Entities, the Special Entity represents that it complied in good faith with policies and procedures to select a qualified independent representative; the representative represents that it has policies and procedures designed to ensure that it satisfies the applicable criteria, that it meets the independence test, and is legally obligated to comply with the applicable duties to the Special Entity.

Independence test: a representative will be deemed independent of the SD/MSP if:

- The representative was not an associated person of the SD/MSP within one year of the representation
- There is no principal relationship between the representative and SD/MSP
- The representative discloses to the Special Entity all material conflicts of interest that could reasonably affect the judgment of the representative with respect to its duties to the Special Entity, and complies with policies and procedures designed to manage and mitigate such material conflicts of interest
- There is no common control between the representative and SD/MSP
- The SD/MSP does not refer or recommend the representative to the Special Entity within a year of the representation

Political contributions by swap dealers

Two-year prohibition on entering swaps with a governmental Special Entity when SD makes certain political contributions to officials of the governmental Special Entity

Means of compliance with business conduct standards

As appropriate, SDs/MSPs can:

- reasonably rely on representations of counterparties to meet due diligence obligations
- make disclosures by any reliable means agreed to by the counterparty
- make disclosures of material information to counterparties in a standard format
- include representations and disclosures in counterparty relationship documentation, and deem them renewed with each subsequent swap

Regulatory Intersections

Department of Labor (DOL) ERISA Fiduciary Regulations

- The Commission has coordinated with DOL to ensure that the final rules are appropriately harmonized with ERISA and DOL regulations. The Commission understands from DOL that compliance with the

business conduct standards statutory provisions and Commission rules will not, by itself, cause SDs/MSPs to be an ERISA fiduciary to an ERISA plan.

Securities and Exchange Commission (SEC) Municipal Advisor Registration

- Independent representatives that advise State and municipal Special Entities on swaps and related activities may be subject to registration with both the Commission as a commodity trading advisor (CTA) and the SEC as a municipal advisor. Commission staff is consulting with SEC, National Futures Association and Municipal Securities Rulemaking Board to harmonize requirements for CTAs and municipal advisors.
- Commission staff continues to consult with SEC staff regarding the proposed municipal advisor registration requirements to address the treatment of SDs/MSPs that comply with the Commission's business conduct standards rules.

CTA Status for SDs

- The final rules add a new exclusion from the CTA definition for SDs whose recommendations or advice are solely incidental to their business as SDs.