

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Part 201

[Release No. 34-75612; File No. S7-14-15]

RIN 3235-AL76

#### Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons To Effect or Be Involved in Effecting Security-Based Swaps

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** Pursuant to Section 15F(b)(6) of the Securities Exchange Act of 1934 (“Exchange Act”), as added by Section 764(a) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), the Securities and Exchange Commission (“Commission”) is proposing Rule of Practice 194. Proposed Rule of Practice 194 would provide a process for a registered security-based swap dealer or major security-based swap participant (collectively, “SBS Entity”) to make an application to the Commission for an order permitting an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity. Proposed Rule of Practice 194 also would exclude an SBS Entity, subject to certain limitations, from the prohibition in Exchange Act Section 15F(b)(6) with respect to associated persons that are not natural persons for a period of 30 days following the associated person becoming subject to a statutory disqualification or 30 days following the person that is subject to a statutory disqualification becoming an associated person of an SBS Entity; for a period of 180 days following the filing of a complete application under proposed Rule of Practice 194 and notice if the application and notice are filed within the same 30-day time period; and for a period of 180 days following the filing of a complete application with, or initiation of a process by, the Commodity Futures Trading Commission (“CFTC”), a self-regulatory organization (“SRO”) or a registered futures association pending a final decision with respect to an application or process with respect to the associated person for the membership, association, registration or listing as a principal, where the application has been filed or process started prior to or within the same 30-day time period and a notice

has been filed with the Commission within the same 30-day time period. The proposed Rule of Practice 194 also would provide, in certain circumstances, for an extension of the temporary exclusion from the prohibition in Exchange Act Section 15F(b)(6) with respect to associated persons that are not natural persons to comply with the prohibition in Section 15F(b)(6). Finally, proposed Rule of Practice 194 would provide that, subject to certain conditions, an SBS Entity may permit an associated person that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, without making an application pursuant to the proposed rule, where the Commission, CFTC, an SRO or a registered futures association has granted a prior application or otherwise granted relief from a statutory disqualification with respect to that associated person.

**DATES:** Comments must be received on or before October 26, 2015.

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

#### Electronic Comments

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-14-15 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### Paper Comments

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090. All submissions should refer to File Number S7-14-15. 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 Web site (<http://www.sec.gov/rules/other.shtml>). Comments are also available for Web site viewing and printing in the Commission’s Public Reference Room, 100 F Street NE., Washington DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should only submit 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 Commission’s Web site. To ensure direct electronic receipt of such notifications, sign up through the “Stay Connected” option at [www.sec.gov](http://www.sec.gov) to receive notifications by email.

#### FOR FURTHER INFORMATION CONTACT:

Paula R. Jenson, Deputy Chief Counsel, Joseph Furey, Assistant Chief Counsel, Bonnie Gauch, Senior Special Counsel, Joanne Rutkowski, Senior Special Counsel, Natasha Vij Greiner, Branch Chief, Jonathan C. Shapiro, Special Counsel, at 202-551-5550, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-7010.

**SUPPLEMENTARY INFORMATION:** The Commission is proposing for public comment Rule of Practice 194 [17 CFR 201.194], under Exchange Act Section 15F(b)(6) [15 U.S.C. 78o-10(b)(6)].

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## I. Background

Exchange Act Section 15F(b)(6), as added by Section 764(a) of the Dodd-Frank Act, makes it unlawful for an SBS Entity to permit an associated person<sup>1</sup> who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity if the SBS Entity knew, or in the exercise of reasonable care should have known, of the statutory disqualification, “[e]xcept to the extent otherwise specifically provided by rule, regulation, or order of the Commission.”<sup>2</sup> In this regard, Exchange Act Section 15F(b)(6) gives the Commission the discretion to

<sup>1</sup> Exchange Act Section 3(a)(70) generally defines the term “persons associated with” an SBS Entity to include (i) any partner, officer, director, or branch manager of an SBS Entity (or any person occupying a similar status or performing similar functions); (ii) any person directly or indirectly controlling, controlled by, or under common control with an SBS Entity; or (iii) any employee of an SBS Entity. *See* 15 U.S.C. 78c(a)(70). The definition generally excludes persons whose functions are solely clerical or ministerial. *Id.* The definition of “person” under Exchange Act Section 3(a)(9) is not limited to natural persons, but extends to both entities and natural persons. 15 U.S.C. 78c(a)(9) (“The term ‘person’ means a natural person, company, government, or political subdivision, agent, or instrumentality of a government.”).

<sup>2</sup> Exchange Act Section 15F(b)(6) provides: “Except to the extent otherwise specifically provided by rule, regulation, or order of the Commission, it shall be unlawful for a security-based swap dealer or a major security-based swap participant to permit any person associated with a security-based swap dealer or a major security-based swap participant who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant, if the security-based swap dealer or major security-based swap participant knew, or in the exercise of reasonable care should have known, of the statutory disqualification.” 15 U.S.C. 78o-10(b)(6).

determine, by order, that a statutorily disqualified associated person may effect or be involved in effecting security-based swaps on behalf of an SBS Entity, and/or to establish rules concerning the statutory prohibition in Exchange Act Section 15F(b)(6).

To date, however, the Commission has not established a separate, more specific rule by which an SBS Entity may apply to the Commission to permit an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity. This proposal, if adopted, would establish such a rule. The proposal would specify the process for obtaining relief from the statutory prohibition in Exchange Act Section 15F(b)(6), including by setting forth the required showing, the form of application and the items to be addressed with respect to associated persons that are natural persons and that are not natural persons.

The proposal would provide a temporary exclusion from the prohibition in Exchange Act Section 15F(b)(6) that would apply both to the case where (i) an associated person entity that is already effecting or involved in effecting security-based swaps on behalf of an SBS Entity becomes subject to a statutory disqualification, and (ii) an entity that is already subject to a statutory disqualification becomes an associated person that is effecting or involved in effecting security-based swaps on behalf of an SBS Entity. Specifically, an SBS Entity would be temporarily excluded from the prohibition in Exchange Act Section 15F(b)(6) with respect to associated person entities (i) for a period of 30 days following the associated person becoming subject to a statutory disqualification or 30 days following the person that is subject to a statutory disqualification becoming an associated person of an SBS Entity; (ii) for a period of 180 days following the filing of a complete application under proposed Rule of Practice 194 and notice if the application and notice are filed within the same 30-day time period; and (iii) for a period of 180 days following the filing of a complete application with, or initiation of a process by, the CFTC, an SRO<sup>3</sup> or a registered futures association with respect to the associated person for the membership, association,

<sup>3</sup> “Self-regulatory organization” is defined in Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26)) as “any national securities exchange, registered securities association, or registered clearing agency, or (solely for the purposes of sections 19(b), 19(c) and 23(b) of [the Exchange Act]) the Municipal Securities Rulemaking Board established by section 15B of [the Exchange Act].”

registration or listing as a principal, where the application has been filed or process started prior to or within the same 30-day time period and a notice is filed with the Commission within the same 30-day period. The proposed Rule of Practice 194 also provides, in certain circumstances, an extension of the temporary exclusion from the prohibition in Exchange Act Section 15F(b)(6) with respect to associated person entities to comply with the prohibition in Section 15F(b)(6) in cases where the temporary exclusion expires or where there is an adverse decision.

Finally, this proposal would provide that an SBS Entity may permit, subject to certain conditions, an associated person (whether a natural person or an entity) that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity, without making an application, where the Commission, CFTC, an SRO or a registered futures association has granted a prior application or otherwise granted relief from a statutory disqualification with respect to the associated person.

### A. Registration Proposing Release

On October 12, 2011, the Commission proposed requirements for an SBS Entity to register with the Commission, as well as additional provisions related to registration.<sup>4</sup> In the Registration Proposing Release, the Commission solicited comment on potentially developing an alternative process, in accordance with Exchange Act Section 15F(b)(6), to establish exceptions to the statutory prohibition in Exchange Act Section 15F(b)(6).<sup>5</sup> In doing so, the Commission noted that Section 15F(b)(6) expressly authorizes the Commission to establish exceptions to the prohibition by rule, regulation or order.<sup>6</sup> The Commission also solicited comment on whether the Commission should consider excepting entities from the statutory prohibition in Exchange Act Section 15F(b)(6).<sup>7</sup>

The Commission received one comment relevant to potentially developing an alternative process to establish exceptions to Exchange Act Section 15F(b)(6).<sup>8</sup> The commenter

<sup>4</sup> Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 65543 (Oct. 12, 2011), 76 FR 65784 (Oct. 24, 2011) (“Registration Proposing Release”).

<sup>5</sup> *Id.* at 65797.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 65797 (Question 90).

<sup>8</sup> *See* Letter from Kenneth E. Bentsen, Jr., Securities Industry and Financial Markets Association, dated December 16, 2011 (“12/16/2011 SIFMA Letter”), at 8.

stated that, based on the Commission's definition of the phrase "involved in effecting," SBS Entities could have hundreds, if not thousands, of associated natural persons who will effect or will be involved in effecting security-based swaps.<sup>9</sup> Moreover, the commenter stated that the definition of "associated person" could be read to extend not just to natural persons, but also to non-natural persons (e.g., entities) that are affiliates of SBS Entities.<sup>10</sup> As a result, the commenter stated, prohibiting statutorily disqualified entities from effecting or being involved in effecting security-based swaps could result in "considerable" business disruptions and other ramifications.<sup>11</sup>

To address these concerns, the commenter stated that the Commission should narrow the scope of the associated persons considered to be effecting or involved in effecting security-based swaps, or, alternatively, exercise its statutory authority to grant exceptions to the general ban on an SBS Entity from associating with a person subject to a statutory disqualification.<sup>12</sup>

### B. Registration Adopting Release

Concurrent with the issuance of this proposing release,<sup>13</sup> the Commission is adopting registration requirements for SBS Entities.<sup>14</sup> Several aspects of the adopted rules relate to the statutory prohibition in Exchange Act Section 15F(b)(6). In particular, the Commission

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* The commenter did not provide supporting data to quantify the number of associated persons or the magnitude of any potential business disruptions.

<sup>12</sup> *Id.*

<sup>13</sup> On June 15, 2011, the Commission issued an order that, among other things, granted temporary relief from compliance with Exchange Act Section 15F(b)(6), and Exchange Act Section 29(b), 15 U.S.C. 78cc(b), concerning enforceability of contracts that would violate, among other provisions, Exchange Act Section 15F(b)(6). See Temporary Exemptions and Other Temporary Relief, Together With Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, Exchange Act Release No. 64678 (June 15, 2011), 76 FR 36287, 36301, 36305-07 (June 22, 2011) ("Temporary Exemptions Order"). Under the Temporary Exemptions Order, persons subject to a statutory disqualification who were, as of July 16, 2011, associated with an SBS Entity and who effected or were involved in effecting security-based swaps on behalf of such SBS Entity could continue to be associated with an SBS Entity until the date upon which rules adopted by the Commission to register SBS Entities became effective. The Commission will consider separately the expiration date of the temporary relief.

<sup>14</sup> Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 75611 (Aug. 5, 2015) (the "Registration Adopting Release").

adopted Exchange Act Rule 15Fb6-1,<sup>15</sup> which provides that, unless otherwise ordered by the Commission, an SBS Entity, when it files an application to register with the Commission as a security-based swap dealer or major security-based swap participant, may permit an associated person that is not a natural person and that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, provided that the statutory disqualification(s) under Exchange Act Section 3(a)(39)(A) through (F)<sup>16</sup> occurred prior to the compliance date set forth in the Registration Adopting Release. SBS Entities seeking to avail themselves of the relief for disqualified associated entities will have to provide a list of disqualified associated entities, which will be made public by the Commission as part of the registration application.<sup>17</sup>

The Commission also adopted a requirement in Rule 15Fb6-2 that the Chief Compliance Officer of an SBS Entity certify on Form SBSE-C that it has performed background checks on all of its associated persons that are natural persons who effect or are involved in effecting security-based swaps on its behalf, and neither knows, nor in the exercise of reasonable care should have known, that any of its associated persons that effect or are involved in effecting security-based swaps on its behalf are subject to a statutory disqualification, unless otherwise specifically provided by rule, regulation or order of the Commission.<sup>18</sup>

Finally, the Commission modified its guidance on the scope of the phrase "involved in effecting" security-based swaps, as that phrase is used in Exchange Act Section 15F(b)(6).<sup>19</sup>

<sup>15</sup> 17 CFR 240.15Fb6-1.

<sup>16</sup> 15 U.S.C. 78c(a)(39)(A)-(F). As stated in the Registration Adopting Release, we intend for this description to parallel Exchange Act Section 3(a)(39). If Congress were to amend the definition of statutory disqualification in Exchange Act Section 3(a)(39), we believe it would be appropriate for the Commission to consider amending Exchange Act Rule 15Fb6-2, 17 CFR 240.14Fb6-2, to assure that this description remains consistent with the statutory definition. See Registration Adopting Release, at Note 63.

<sup>17</sup> See Registration Adopting Release, at Section II.B.1.i.

<sup>18</sup> See Rule 15Fb6-2(a) and Form SBSE-C; see also Registration Adopting Release, at Section II.B.3.

<sup>19</sup> Specifically, the Commission stated that the term "involved in effecting security-based swaps" generally means engaged in functions necessary to facilitate the SBS Entity's security-based swap business, including, but not limited to the following activities: (1) Drafting and negotiating master agreements and confirmations; (2) recommending security-based swap transactions to counterparties; (3) being involved in executing security-based swap transactions on a trading desk; (4) pricing security-based swap positions; (5) managing collateral for

## II. Discussion

### A. Overview of Proposed Rule

The Commission is proposing Rule of Practice 194, which would provide a process by which an SBS Entity could apply to the Commission for an order permitting an associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity where the associated person is subject to a statutory disqualification<sup>20</sup> and is thereby otherwise prohibited from effecting or being involved in effecting security-based swaps on behalf of an SBS Entity under Exchange Act Section 15F(b)(6). For the Commission to issue an order granting relief under proposed Rule of Practice 194, an SBS Entity would be required to make a showing that it would be consistent with the public interest to permit the associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity, notwithstanding the statutory disqualification.

The rule would prescribe the form of application and the items to be addressed with respect to an associated person that is a natural person or entity. The rule would also provide for notice to the applicant in cases where the Commission staff anticipates making an adverse recommendation to the Commission with respect to an application made pursuant to this rule. In such cases, the applicant would be provided with a written statement of the reasons for the Commission staff's preliminary recommendation, and the applicant would have 30 days to submit a written statement in response.

The Commission is also proposing paragraph (i) to proposed Rule of

the SBS Entity; and (6) directly supervising persons engaged in the activities described in items (1) through (5) above. See Registration Adopting Release, at Section II.B.1.ii.

<sup>20</sup> Under Exchange Act Rule 15Fb6-1, 17 CFR 240.15Fb6-1, unless otherwise ordered by the Commission, an SBS Entity, when it files an application to register with the Commission as a security-based swap dealer or major security-based swap participant, may permit an associated person that is not a natural person and that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, provided that the statutory disqualification(s) under Exchange Act Section 3(a)(39)(A) through (F), 15 U.S.C. 78c(a)(39)(A)-(F), occurred prior to the compliance date set forth in the Registration Adopting Release, and provided that it identifies each such associated person on Schedule C of Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate. As a result, at the time a security-based swap dealer or major security-based swap participant submits an application to register as an SBS Entity, it would not have to file an application with the Commission under proposed Rule of Practice 194 with respect to an associated person entity that is subject to a statutory disqualification that occurred prior to the compliance date set forth in the Registration Adopting Release. See Registration Adopting Release, at Section II.B.1.i.

Practice 194, which would provide that an SBS Entity shall be temporarily excluded from the prohibition in Exchange Act Section 15F(b)(6) with respect to a statutorily disqualified associated person that is not a natural person (i) for a period of 30 days following the associated person becoming subject to a statutory disqualification or 30 days following the person that is subject to a statutory disqualification becoming an associated person of an SBS Entity, (ii) for a period of 180 days following the filing of a complete application under proposed Rule of Practice 194 and notice if the application and notice are filed within the same 30-day time period; and (iii) for a period of 180 days following the filing of a complete application with, or initiation of a process by, the CFTC, an SRO or a registered futures association with respect to the associated person for the membership, association, registration or listing as a principal, where the application has been filed or process started prior to or within the same 30-day time period and a notice has been filed with the Commission within the same 30-day time period. Proposed Rule of Practice 194(i) also provides in paragraphs (i)(1)(ii), (i)(1)(iii) and (i)(3) for an extension of the temporary exclusion to comply with the statutory prohibition in Exchange Act Section 15F(b)(6).

In addition, the Commission is proposing paragraph (j) to Rule of Practice 194, which provides that, where certain conditions are met, an SBS Entity would not need to file an application under proposed Rule of Practice 194 to permit a statutorily disqualified associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity. Specifically, paragraph (j) to proposed Rule of Practice 194 would allow an SBS Entity, subject to certain conditions, to permit a statutorily disqualified associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity without making an application to the Commission, where the Commission, CFTC, an SRO (e.g., FINRA or a national securities exchange), or a registered futures association (e.g., the National Futures Association (“NFA”)) has granted a prior application or otherwise granted relief from a statutory disqualification with respect to that associated person. In such cases where an SBS Entity meets the requirements of proposed paragraph (j), the SBS Entity would be permitted to file notice with the Commission (in lieu of an application).

### *B. Consistency With Other Processes for Permitting Association Notwithstanding a Statutory Disqualification or Other Bar*

Under the federal securities laws, certain registered entities have various procedural avenues to be able to associate, where warranted, with persons subject to a statutory disqualification or other bar, including the Commission’s Rule of Practice 193<sup>21</sup> and Financial Industry Regulatory Authority (“FINRA”) eligibility proceedings (under the process set forth in Exchange Act Rule 19h–1).<sup>22</sup> As detailed below in Section II.C, Proposed Rule of Practice 194 is modeled on these existing processes where persons can reenter the industry despite previously being barred by the Commission or to associate with a member of an SRO notwithstanding a statutory disqualification. Proposed Rule of Practice 194 would establish a procedural framework that is similar to processes that are familiar to market participants.

#### 1. Rule of Practice 193

Rule of Practice 193 provides a process by which individuals that are not regulated by an SRO (e.g., employees of an investment adviser, an investment company, or a transfer agent) can seek to reenter the securities industry despite previously being barred by the Commission.<sup>23</sup>

The rule requires the filing of an affidavit from the individual, addressing, among other items, (1) the time period since the imposition of the bar; (2) any restitution or similar action taken by the individual to recompense any person injured by the misconduct that resulted in the bar; (3) the individual’s employment during the period subsequent to imposition of the bar; (4) the capacity or position in which the individual proposes to be associated; (5) the manner and extent of supervision to be exercised over such individual and, where applicable, by such individual and (6) any relevant courses, seminars, examinations or other actions completed by the

individual subsequent to imposition of the bar to prepare for his or her return to the securities business.<sup>24</sup>

Rule 193 also requires a written statement from the proposed employer, describing, among other things, the terms and conditions of employment and the supervision to be exercised over the barred individual.<sup>25</sup>

#### 2. FINRA Eligibility Proceedings

Under Exchange Act Section 15A(g)(2), “[a] registered securities association may, and in cases in which the Commission, by order, directs as necessary or appropriate in the public interest or for the protection of investors shall, deny membership to any registered broker or dealer, and bar from becoming associated with a member any person, who is subject to a statutory disqualification.”<sup>26</sup> Consistent with that provision, Article III, Section 3 of the FINRA By-Laws provides that no person shall be associated with a member, continue to be associated with a member, or transfer association to another member if such person is or becomes subject to a disqualification; and, that no person shall be admitted to membership, and no member shall be continued in membership, if any person associated with it is subject to a disqualification.<sup>27</sup> Under Article III, Section 4 of the FINRA By-Laws, a person is subject to a “disqualification” with respect to membership, or association with a member, if such person is subject to any “statutory disqualification” as such term is defined in Exchange Act Section 3(a)(39).<sup>28</sup> Article III, Section 3(d) of FINRA’s By-Laws permits a disqualified person or member to request permission to enter or remain in the securities industry.<sup>29</sup> Consistent with Exchange Act Section 15A(g)(2),<sup>30</sup> under Article 3, Section 3(d) of the FINRA By-Laws, the FINRA Board may, in its discretion approve the continuance in membership, and may also approve the association or continuance of association of any person, if the FINRA Board determines that such approval is consistent with the

<sup>21</sup> 17 CFR 201.193.

<sup>22</sup> 17 CFR 240.19h–1.

<sup>23</sup> 17 CFR 201.193; see also Registration Proposing Release, 76 FR at 65797; Applications by Barred Individuals for Consent to Associate With a Registered Broker, Dealer, Municipal Securities Dealer, Investment Adviser or Investment Company, Exchange Act Release No. 20783, Investment Company Act Release No. 13839, Investment Advisers Act Release No. 903, 49 FR 12204 (Mar. 29, 1984) (“Applications by those barred individuals who seek to associate with an investment adviser, investment company, or other entity that is not a member of an SRO, should be submitted directly to the Commission pursuant to Rule 29 [current Rule 193]”).

<sup>24</sup> 17 CFR 201.193(b), (d).

<sup>25</sup> 17 CFR 201.193(b)(4)(i)–(iv).

<sup>26</sup> 15 U.S.C. 78o–3(g)(2).

<sup>27</sup> See FINRA By-laws, Article III, Section 3, [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=4606](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4606).

<sup>28</sup> See FINRA By-Laws, Article III, Section 4, [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=4607](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4607); 15 U.S.C. 78c(a)(39).

<sup>29</sup> See FINRA By-laws, Article III, Section 3, at Note 27, *supra*.

<sup>30</sup> 15 U.S.C. 78o–3(g)(2).

public interest and the protection of investors.<sup>31</sup>

The FINRA Rule 9520 Series sets forth procedures for a person to become or remain associated with a member, notwithstanding the existence of a statutory disqualification, and for a current member or person associated with a member to obtain relief from the eligibility or qualification requirements of the FINRA By-Laws and rules.<sup>32</sup> A member (or new member applicant) seeking to associate with a natural person subject to a statutory disqualification must seek approval from FINRA by filing a Form MC-400 application.<sup>33</sup> Members (and new member applicants) that are themselves subject to a disqualification that wish to obtain relief from the eligibility requirements are required to submit a Form MC-400A application.<sup>34</sup>

Where required, FINRA sends a notice or notification to the Commission of its proposal to admit or continue the membership of a person or association with a member notwithstanding statutory disqualification in accordance with Exchange Act Rule 19h-1.<sup>35</sup> Exchange Act Rule 19h-1 provides for Commission review of notices filed by SROs proposing to admit any person to, or continue any person in, membership or association with a member, notwithstanding statutory disqualification. However, Exchange Act Rule 19h-1(a)(2)<sup>36</sup> and (3)<sup>37</sup> provide that, for certain persons, and in limited circumstances, a notice does not need to be filed. With respect to certain persons subject to a statutory

disqualification, under Exchange Act Rule 19h-1(a)(4),<sup>38</sup> an SRO is required to furnish to the Commission a notification (containing less information than a notice). Under Exchange Act Section 15A(g)(2),<sup>39</sup> where it is necessary or appropriate in the public interest or for the protection of investors, the Commission may, by order, direct the SRO to deny membership to any registered broker or dealer, and bar from becoming associated with a member any person, who is subject to a statutory disqualification.

### 3. CFTC's Approach to Associated Persons of Swap Entities Subject to a Statutory Disqualification

The statutory prohibition in Exchange Act Section 15F(b)(6)<sup>40</sup> is parallel to a statutory provision for a swap dealer or major swap participant (collectively "Swap Entity") as set forth in Section 4s(b)(6) of the Commodity Exchange Act ("CEA").<sup>41</sup> With respect to statutorily disqualified associated persons of Swap Entities, the CFTC, among other things:

- Defined associated persons of Swap Entities to be limited to natural persons.<sup>42</sup> As a result, the prohibition in Section 4s(b)(6) of the CEA<sup>43</sup> applies to natural persons associated with a Swap Entity (not entities).
- Adopted Regulation 23.22(b), permitting association with a Swap Entity with respect to a person who is already listed as a principal, registered

<sup>38</sup> 17 CFR 240.19h-1(a)(4). A notification must be filed if the person or member proposed for continued association or membership, respectively, satisfies the requirements of Exchange Act Rule 19h-1(a)(3)(ii), (iv) or (v). 17 CFR 240.19h-1(a)(3)(ii), (iv), (v).

<sup>39</sup> 15 U.S.C. 78o-3(g)(2).

<sup>40</sup> 15 U.S.C. 78o-10(b)(6).

<sup>41</sup> See 7 U.S.C. 6s(b)(6), which states, "Except to the extent otherwise specifically provided by rule, regulation, or order, it shall be unlawful for a swap dealer or a major swap participant to permit any person associated with a swap dealer or a major swap participant who is subject to a statutory disqualification to effect or be involved in effecting swaps on behalf of the swap dealer or major swap participant, if the swap dealer or major swap participant knew, or in the exercise of reasonable care should have known, of the statutory disqualification."

<sup>42</sup> Specifically, the CFTC amended CEA Regulation 1.3(aa), 17 CFR 1.3(aa), which generally defines the term "associated person" for purposes of entities registered with it, to cover Swap Entities. Consequently, with respect to Swap Entities, the definition reads, "(aa) *Associated Person*. This term means any natural person who is associated in any of the following capacities with: . . . (6) A swap dealer or major swap participant as a partner, officer, employee, agent (or any natural person occupying a similar status or performing similar functions), in any capacity that involves: (i) The solicitation or acceptance of swaps (other than in a clerical or ministerial capacity); or (ii) The supervision of any person or persons so engaged."

<sup>43</sup> See 7 U.S.C. 6s(b)(6).

as an associated person of another CFTC registrant, or registered as a floor broker or floor trader, notwithstanding that the person is subject to a statutory disqualification under the CEA.<sup>44</sup> With respect to those applicants or registrants, NFA Registration Rule 504 sets forth procedures governing applicants and registrants statutorily disqualified from registration under CEA Section 8a(2), 8a(3) or 8a(4).<sup>45</sup> Under NFA Registration Rules 504(b)(2) and 507, the applicant or registrant must show that, notwithstanding the existence of a statutory disqualification, his registration would pose no substantial risk to the public.<sup>46</sup> Likewise, under CFTC Regulation 3.60(b)(2)(i), (e)(1) and (2)<sup>47</sup> an applicant or registrant must show that registration would not pose a substantial risk to the public despite the existence of the statutory disqualification.<sup>48</sup>

<sup>44</sup> See Registration of Swap Dealers and Major Swap Participants, 77 FR 2613, 2315 (Jan. 19, 2012) ("CFTC Registration Release"). Specifically, CFTC Regulation 23.22(b) provides: "No swap dealer or major swap participant may permit a person who is subject to a statutory disqualification under section 8a(2) or 8a(3) of the [CEA] to effect or be involved in effecting swaps on behalf of the [Swap Entity], if the [Swap Entity] knows, or in the exercise of reasonable care should know, of the statutory disqualification: Provided, however, that the prohibition set forth in this paragraph (b) shall not apply to any person listed as a principal or registered as an associated person of a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity pool operator, commodity trading advisor, or leverage transaction merchant, or any person registered as a floor broker or floor trader, notwithstanding that the person is subject to a disqualification from registration under section 8a(2) or 8a(3) of the [CEA]." 17 CFR 23.22(b).

<sup>45</sup> 7 U.S.C. 12a(2), (3) or (4).

<sup>46</sup> Specifically, under NFA Registration Rule 507(a)(1), in actions involving statutory disqualification set forth in CEA Section 8a(2), 7 U.S.C. 12a(2), the applicant or registrant must make a clear and convincing showing that, notwithstanding the existence of the statutory disqualification, full or conditioned registration would not pose a substantial risk to the public; under NFA Registration Rule 507(a)(2), in actions involving statutory disqualification set forth in CEA Section 8a(3) or 8a(4), 7 U.S.C. 12a(3) or (4), the applicant or registrant must show by a preponderance of the evidence that, notwithstanding the existence of the statutory disqualification, full or conditioned registration would not pose a substantial risk to the public.

<sup>47</sup> 17 CFR 3.60(b)(2)(i), (e)(1), (e)(2).

<sup>48</sup> Under CFTC Regulation 3.60(e)(1), 17 CFR 3.60(e)(1), in actions involving statutory disqualifications set forth in CEA Section 8a(2), 7 U.S.C. 12a(2), the applicant or registrant must make a clear and convincing showing that full, conditioned or restricted registration would not pose a substantial risk to the public despite the existence of the statutory disqualification. Under CFTC Regulation 3.60(e)(2), 17 CFR 3.60(e)(2), in actions involving statutory disqualifications set forth in CEA Section 8a(3) or 8a(4), 7 U.S.C. 12a(3) or (4), the applicant or registrant must make a showing by a preponderance of the evidence that full, conditioned or restricted registration would not pose a substantial risk to the public despite the existence of the statutory disqualification.

<sup>31</sup> See FINRA Rules 9522(e), 9524(b)(1).

<sup>32</sup> See FINRA Rule 9520 Series, [http://finra.complinet.com/en/display/display\\_viewall.html?rbrid=2403&element\\_id=3985&record\\_id=5063&filtered\\_tag=](http://finra.complinet.com/en/display/display_viewall.html?rbrid=2403&element_id=3985&record_id=5063&filtered_tag=)

<sup>33</sup> See FINRA Form MC-400, *Membership Continuance Application*, <http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/industry/p011542.pdf>.

<sup>34</sup> See FINRA Form MC-400A, *Membership Continuance Application: Member Firm Disqualification Application*, <http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/industry/p013339.pdf>.

<sup>35</sup> 17 CFR 240.19h-1.

<sup>36</sup> Exchange Act Rule 19h-1(a)(2), 17 CFR 240.19h-1(a)(2), provides that a notice need not be filed with the Commission, pursuant to Exchange Act Rule 19h-1, regarding an associated person subject to a statutory disqualification if the person's activities with respect to the member are solely clerical or ministerial in nature and such person does not have access to funds, securities, or books and records.

<sup>37</sup> Exchange Act Rule 19h-1(a)(3), 17 CFR 240.19h-1(a)(3), provides that a notice need not be filed with the Commission, pursuant to Exchange Act Rule 19h-1, regarding a person or member subject to a statutory disqualification if the person or member proposed for continued association or membership, respectively, satisfies the requirements of Exchange Act Rule 19h-1(a)(3)(i)-(vi).

• In addition, CFTC staff has issued no-action relief to Swap Entities that allows them to permit a statutorily disqualified associated person to effect or be involved in effecting swap transactions on behalf of a Swap Entity, provided that NFA provides notice to the Swap Entity that, had the person applied for registration as an associated person, NFA would have granted such registration.<sup>49</sup> NFA has established a process by which such associated persons of Swap Entities may apply for relief from CEA Section 4s(b)(6).<sup>50</sup>

### C. Proposed Rule of Practice 194

#### 1. Scope of the Rule

Proposed paragraph (a) defines the scope of proposed Rule of Practice 194, providing a process for submitting applications by an SBS Entity seeking an order of the Commission permitting an associated person that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity. The proposed rule would allow an SBS Entity to voluntarily submit an application to the Commission to request an order where an associated person of an SBS Entity is subject to a statutory disqualification and thereby prohibited from effecting or being involved in effecting security based swaps on behalf of the SBS Entity under Exchange Act Section 15F(b)(6).<sup>51</sup>

Notably, however, where the conditions set forth in proposed paragraph (j) are met, an SBS Entity would not need to file an application under Rule of Practice 194 to permit a statutorily disqualified associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity. In such instances, a more limited notification would be required.

#### 2. Required Showing

Proposed paragraph (b) sets forth the required showing for an application under proposed Rule of Practice 194. For the Commission to issue an order granting relief under proposed Rule of Practice 194, the Commission would need to find that it would be consistent with the public interest to permit the associated person of the SBS Entity who

is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity.

In meeting the burden of showing that permitting the associated person to effect or be involved in effecting security based swaps on behalf of the SBS Entity is consistent with the public interest, the application and supporting documentation must demonstrate that the terms or conditions of association, procedures, or proposed supervision (if the associated person is a natural person), for an associated person are reasonably designed to ensure that the statutory disqualification does not negatively impact upon the ability of the associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity in compliance with the applicable statutory and regulatory framework. In addition to the items set forth in paragraphs (d) and (f) of proposed Rule of Practice 194, the Commission would consider the nature of the findings that resulted in the statutory disqualification in determining whether the association is consistent with the public interest.

The Commission preliminarily believes that the public interest standard is appropriate because it is consistent with the overall purpose of the Exchange Act, and specifically for “transactions in securities . . . [to be] effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto.”<sup>52</sup> By prohibiting an SBS Entity from allowing a statutorily disqualified associated person from effecting or being involved in effecting security-based swap transactions, absent Commission relief, we believe that Exchange Act Section 15F(b)(6) is designed to limit the potential that associated persons who have engaged in certain types of “bad acts” will be able to negatively impact the security-based swap market, and the participants and investors in that market. However, Section 15F(b)(6) also specifically provides that the Commission can allow SBS Entities to continue to permit such statutorily disqualified associated persons to effect or be involved in effecting security-based swap transactions. The Commission preliminarily believes that the public interest standard is intended to capture those situations where the risk of the associated person engaging in security-based swap activity that may harm the market or the participants in

the market is mitigated. For example, other items including, but not limited to, other misconduct in which the associated person may have engaged, the nature and disciplinary history of the associated person and SBS Entity requesting such relief, and the supervision to be accorded the associated person, would be relevant to the Commission’s consideration of whether the risks of permitting such associated persons to effect or be involved in effecting security-based swaps on behalf of the SBS Entity are sufficiently mitigated. The Commission preliminarily believes that the public interest standard appropriately reflects this type of analysis.<sup>53</sup>

#### 3. Form of Application for Natural Persons and Entities

Proposed paragraphs (c) and (e) specify the form of the application to be submitted under proposed Rule of Practice 194 for natural persons and entities (respectively). Proposed paragraphs (c) and (e) would require that each application with respect to an associated person subject to a statutory disqualification shall be supported by a written statement, signed by a knowledgeable person authorized by the SBS Entity, which addresses the items in proposed Rule of Practice 194(d) and (f).<sup>54</sup>

The Commission proposes that the SBS Entity (rather than the associated person) submit the application, including by providing the signed written statement under proposed paragraphs (c) and (e), for several reasons. First, the SBS Entity is the person that is subject to the restrictions under Exchange Act Section 15F(b)(6). Second, requiring an SBS Entity to submit the written statement with respect to an associated person would reinforce, in certain circumstances, the necessity of additional oversight by the SBS Entity over the associated person that is subject to a statutory disqualification, as SBS Entities would determine what information and documents to include in an application with respect to an associated person.<sup>55</sup> Third, as specified below, the Commission is proposing to require information (e.g., concerning the supervision by the SBS Entity over the

<sup>49</sup> See Staff No-Action Positions: Registration Relief for Certain Persons, CFTC Letter No. 12–15, at 5–8 (Oct. 11, 2012) (“CFTC Staff No-Action Letter”), available at <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/12-15.pdf>.

<sup>50</sup> See NFA, EasyFile AP Statutory Disqualification Form Submission, <https://www.nfa.futures.org/NFA-electronic-filings/easyFile-statutory-disqualification.HTML>.

<sup>51</sup> 15 U.S.C. 78o–10(b)(6).

<sup>52</sup> See, e.g., Exchange Act Section 2, 15 U.S.C. 78b.

<sup>53</sup> A public interest standard also is consistent with the standard in Rule of Practice 193. See 17 CFR 201.193(c).

<sup>54</sup> In addition to the information required in proposed paragraph (c)–(g), the Commission reserves the right to request from the applicant supplementary information to assist in its review. See proposed Rule of Practice 194, Appendix, paragraph (c), and Section II.C.10, *infra*.

<sup>55</sup> See proposed Rule of Practice 194, Appendix, paragraph (b).

associated person) that is within the possession of the SBS Entity itself.<sup>56</sup>

The application would be filed pursuant to Rules of Practice 151, 152 and 153.<sup>57</sup> The Commission believes filing pursuant to these rules would provide the Commission with the information that it needs to assess an application under proposed Rule of Practice 194.

Proposed paragraphs (c) and (e) would require that the following exhibits be included with an application to help the Commission assess whether it is consistent with the public interest to allow the associated person to effect or be involved in effecting security-based swaps on behalf of an SBS Entity:

- Proposed paragraphs (c)(1) and (e)(1) would require a copy of the order or other applicable document that resulted in the associated person being subject to a statutory disqualification. The proposed requirement would help inform the Commission about the nature of the conduct that led to the statutory disqualification. For example, in the event that the statutory disqualification arose from misconduct relating to security-based swap transactions in particular, or is otherwise investment-related, it may inform the Commission's decision of whether it is consistent with the public interest for the associated person to effect or be involved in effecting security-based swaps on behalf of an SBS Entity.

- Proposed paragraphs (c)(2) and (e)(2) would require an undertaking by the applicant to notify the Commission promptly in writing if any information submitted in support of the application becomes materially false or misleading while the application is pending. This

<sup>56</sup> In addition, requiring an SBS Entity to submit the application would provide a familiar practice, as it is consistent with the current practice for SBS Entities that are registered with FINRA under FINRA Form MC-400. In particular, under FINRA Form MC-400, an application for a statutorily disqualified associated person who is a natural person of a member firm is submitted by a member firm (not by the individual). See FINRA Form MC-400, Note 33, *supra*; see also Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change to Adopt FINRA Rule 1113 (Restriction Pertaining to New Member Applications) and to Amend the FINRA Rule 9520 Series (Eligibility Proceedings), Exchange Act Release No. 63933 (Feb. 18, 2011), 76 FR 10629, 10630 (Feb. 25, 2011) (“A member (or new member applicant) seeking to associate with a person subject to a disqualification must seek approval from FINRA by filing a Form MC-400 application, pursuant to the FINRA Rule 9520 Series.”).

<sup>57</sup> 17 CFR 201.151, 201.152, 201.153. Rule of Practice 151, 17 CFR 201.151, concerns the procedure for filing of papers with the Commission; Rule of Practice 152, 17 CFR 201.152, concerns the form of filing papers with the Commission; Rule of Practice 153, 17 CFR 201.153, concerns the signature requirement and effect of filing papers.

proposed requirement is designed to require that information provided by the applicant be complete and accurate so that the Commission is provided the necessary information in order to effectively evaluate the pending application.

- Proposed paragraphs (c)(4) and (e)(5) would require a copy of any decision, order, or document issued with respect to any proceedings<sup>58</sup> resulting in the imposition of disciplinary sanctions or pending proceeding against the associated person by the Commission, CFTC, any federal or state or law enforcement regulatory agency, registered futures association, foreign financial regulatory authority, registered national securities association, or any other SRO, or commodities exchange, or any court, that occurred during the five years preceding the filing of the application pursuant to proposed Rule of Practice 194. The Commission believes that the information required by this proposed provision would be useful to assess the disciplinary history of the associated person. The disciplinary history of the associated person subject to a statutory disqualification provides the Commission with relevant information to help assess the risk that the associated person may engage in future misconduct. The Commission is requesting the underlying decision, order, or other document itself (as opposed to a description or record of the decision), so that the Commission can directly review the materials to assess the disciplinary history of the associated person. Where the associated person has a history of misconduct, in addition to the conduct that triggered the statutory disqualification, the Commission generally would be less likely to find it in the public interest to permit the associated person to effect or be involved in effecting security-based swaps on behalf of an SBS Entity. In addition, this proposed requirement would help inform the Commission of any pending proceedings against the associated person, which may factor into the totality of the information when

<sup>58</sup> For purposes of providing the information requested by paragraphs (c)(4) and (c)(5), applicants should look to the definition of “proceeding” in Form SBSE, which states that a “proceeding” includes “a formal administrative or civil action initiated by a governmental agency, self-regulatory organization or a foreign financial regulatory authority; a felony criminal indictment or information (or equivalent formal charge); or a misdemeanor criminal information (or equivalent formal charge). Does not include other civil litigation, investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge).” See Registration Adopting Release, at Section II.G.1, and Form SBSE.

the Commission makes a determination as to whether the associated person should be allowed to effect or be involved in effecting security-based swaps on behalf of the SBS Entity. In this context, the Commission preliminarily believes that the five-year timeframe is appropriate. We balanced the burden that may be imposed by requiring SBS Entities to provide older materials and documents that may not be as readily available with our need to evaluate the context and circumstances underlying the application.

In addition to the information above, proposed paragraph (c) of the proposed rule would require that each application with respect to an associated person that is a *natural person* include the following information and documents:

- Proposed paragraph (c)(3) would require a copy of the questionnaire or application for employment specified in Exchange Act Rule 15Fb6-2(b) with respect to the associated person,<sup>59</sup> which would provide the Commission with basic background information concerning the associated person, as well as the disciplinary history of the associated person. Information concerning the disciplinary history of the associated person is important because it may help the Commission assess the risk of future misconduct by the associated person.

Additionally, proposed paragraph (e) of the proposed rule would require that each application with respect to an associated person that is *not a natural person* include the following information and documents:

- Proposed paragraph (e)(3) would require a copy of any organizational charts of the associated person, if available. To the extent that the associated person employs any natural persons subject to a statutory disqualification (which would be required to be disclosed pursuant to paragraph (e)(6) of proposed Rule of Practice 194, discussed *infra*), organizational charts would assist the Commission in assessing whether such natural persons are supervising or being supervised by other natural persons that are also subject to a statutory disqualification, whether directly (*i.e.*, an immediate supervisor) or indirectly. This information would assist the Commission in making its determination because, for example, the concentration of statutorily disqualified natural persons in an associated person entity could pose a greater risk of future misconduct by such associated person entity.

<sup>59</sup> See Registration Adopting Release, at Section II.B.2.

- Proposed paragraph (e)(4) would require a copy of policies and procedures relating to the conduct resulting in the statutory disqualification that the associated person entity has in place to ensure compliance with any federal or state securities laws, the CEA, the rules or regulations thereunder, or the rules of the Municipal Securities Rulemaking Board, any SRO, or any foreign regulatory authority, as applicable. Such information would help inform the Commission as to whether the associated person entity has adequate policies and procedures in place, to the extent applicable, to ensure compliance with the federal securities laws or SRO rules. The information requested here is also consistent with the statutory scheme, as violations of the statutes and regulations listed here may result in a statutory disqualification under Exchange Act Section 3(a)(39).<sup>60</sup> Given that violations of any of the statutes and regulations listed here may result in a statutory disqualification under Section 3(a)(39) of the Exchange Act, the Commission believes that information about the associated person entity's policies and procedures would help inform the Commission as to steps taken to reduce the risk of further misconduct by the associated person entity. In particular, the Commission believes that where the associated person entity does not have sufficient policies and procedures to help ensure compliance with applicable laws, rules and regulations, there is a greater risk that the entity will engage in future misconduct.

- Proposed paragraph (e)(6) would require the name of any natural persons employed by the associated person that are subject to a statutory disqualification and would effect or be involved in effecting security-based swaps on behalf of the SBS Entity. For any such natural person, the applicant should indicate whether the individual is an officer, partner, direct or indirect owner of the associated person. Because an SBS Entity separately would be required to seek relief under proposed Rule of Practice 194 for any such natural persons to be able to effect or be involved in effecting security-based swaps on behalf of the SBS Entity, the application would only require a list of the names, not any further information that would be included in those separate applications.

#### 4. Written Statement for Natural Persons and Entities

Proposed paragraphs (d) and (f) under Rule of Practice 194 set forth the items to be addressed for applications with respect to natural persons and entities (respectively). Each of the items in proposed paragraphs (d) and (f) would be addressed in the written statement required by proposed paragraphs (c) and (e). The Commission believes that the items listed are important to help the Commission assess whether it would be consistent with the public interest to allow the associated person subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity.

- Proposed paragraphs (d)(1) and (f)(2) would require an applicant to address the associated person's compliance with any order resulting in the statutory disqualification, including whether the associated person has paid fines or penalties, disgorged monies, made restitution or paid any other monetary compensation required by any such order. Whether an associated person has complied in full with any order resulting in the statutory disqualification (including with all monetary penalties imposed) could be relevant to assessing whether it is consistent with the public interest to allow the associated person to effect or be involved in effecting security-based swaps on behalf of an SBS Entity. This information could be relevant because the Commission believes that it generally would not be consistent with the public interest to issue an order granting relief under proposed Rule of Practice 194 with respect to persons that have failed to abide by the terms of a prior order resulting in a statutory disqualification. The Commission believes that the failure to comply with an order resulting in the statutory disqualification may be relevant for assessing the risk of whether an associated person subject to a statutory disqualification may engage in future misconduct.

- Proposed paragraphs (d)(3) and (f)(3) would require the applicant to address the capacity or position in which the associated person subject to a statutory disqualification proposes to be associated with the SBS Entity. In addressing the capacity or position in which the associated person subject to a statutory disqualification proposes to be associated with the SBS Entity, the applicant should provide a description of the proposed duties and responsibilities of the associated person. An associated person effecting or

“involved in effecting”<sup>61</sup> security-based swaps on behalf of an SBS Entity may operate in a varied range of capacities or positions, each presenting different risks. As a result, the information requested by paragraphs (d)(3) and (f)(3) would provide information about the nature of the activity that the associated person will be providing for the SBS Entity, and thus may help the Commission assess whether the associated person is engaging in activities that may create greater risks to SBS Entities, counterparties or other persons. In the event a prior application has been submitted with respect to the associated person, as set forth in proposed paragraph (g) to proposed Rule of Practice 194, the SBS Entity should describe in what manner the association will differ, if at all, from the association in any such prior application.

- Proposed paragraphs (d)(6) and (f)(6) would require the applicant to describe the compliance and disciplinary history, during the five years preceding the filing of the application, of the SBS Entity. In addition to the description of the compliance and disciplinary history, the applicant may provide any relevant documentation during the five years preceding the filing of the application, including, but not be limited to, the disclosure reporting pages on Forms SBSE, SBSE-A and SBSE-BD<sup>62</sup> for the SBS Entity with respect to events occurring, along with any letters of caution, deficiency letters or similar documents received from the Commission, an SRO or other law enforcement or regulatory agency. The Commission believes that information regarding the compliance and disciplinary history of the SBS Entity could be useful to the Commission in assessing the risk that the associated person subject to a statutory disqualification may engage in future misconduct. In cases where an associated person subject to a statutory disqualification will be employed at an SBS Entity with significant compliance and disciplinary issues during the five years preceding the filing of an application under proposed Rule of Practice 194, the Commission would consider, among other things noted in this rule, the nature of the conduct that resulted in the statutory disqualification in determining whether the association

<sup>61</sup> See Registration Adopting Release, at Section II.B.1.ii, for discussion of guidance about what it means to be “involved in effecting” security-based swaps in the context of Section 15F(b)(6) of the Exchange Act.

<sup>62</sup> See Registration Adopting Release, at Sections II.G.1, II.G.2, and II.G.3.

<sup>60</sup> See 15 U.S.C. 78c(a)(39); 15 U.S.C. 78o(b)(4).

is consistent with the public interest. In this context, the Commission preliminarily believes that the five-year timeframe is appropriate. We balanced the burden that may be imposed by requiring SBS Entities to provide older materials and documents that may not be as readily available with our need to evaluate the circumstances underlying the application.

- Proposed paragraphs (d)(9) and (f)(5) would require a detailed statement of why the associated person should be permitted to effect or be involved in effecting security-based swaps on behalf of the SBS Entity, including what steps the associated person or applicant have taken, or will take, to ensure that the statutory disqualification does not negatively impact upon the ability of the associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity in compliance with the applicable statutory and regulatory framework. This proposed requirement is designed to provide an opportunity for an applicant to provide a narrative or rationale to explain why it is consistent with the public interest to allow the associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity.

- Proposed paragraphs (d)(10) and (f)(7) would require an applicant to discuss whether, during the five years preceding the filing of the application, the associated person has been involved in any litigation concerning investment or investment-related activities<sup>63</sup> or whether there are there any unsatisfied judgments outstanding against the associated person concerning investment or investment-related activities, to the extent not otherwise covered by proposed paragraph (d)(9); if so, the applicant should provide details regarding such litigation or unsatisfied judgments. The Commission believes information concerning such litigation may factor into the totality of the information when the Commission makes a determination as to whether the associated person should be allowed to

<sup>63</sup> For purposes of providing the information requested by paragraphs (d)(10) and (f)(7), applicants should look to the definition of “investment or investment-related” in Form SBSE, which states that “investment or investment-related” includes “pertaining to securities, commodities, banking, savings association activities, credit union activities, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, investment adviser, futures sponsor, bank, security-based swap dealer, major security-based swap participant, savings association, credit union, insurance company, or insurance agency).” See Registration Adopting Release, Form SBSE.

effect or be involved in effecting security-based swaps on behalf of the SBS Entity. Information concerning unsatisfied judgments outstanding against the associated person concerning investment or investment-related activities may help inform the Commission as to whether the associated person subject to a statutory disqualification has abided by any judgment or order, or has failed to compensate persons as required by a court or other relevant authority. In this context, the Commission preliminarily believes that the five-year timeframe is appropriate. We balanced the burden that may be imposed by requiring SBS Entities to provide older information that may not be as readily available with our need to evaluate the circumstances underlying the application.

- Proposed paragraphs (d)(11) and (f)(8) would require any other information that the applicant believes to be material to the application. This provision is designed to require an applicant to provide all information that likely will be material to the Commission’s consideration of an application under proposed Rule of Practice 194, notwithstanding that such information may not be specifically required by the rule. This provision also is designed to provide the applicant with an opportunity to provide any additional information that the applicant believes is important to the Commission’s consideration of the SBS Entity’s application under proposed Rule of Practice 194, but that is not specifically required by the rule.

In addition to the items discussed above, proposed paragraph (d) of the proposed rule would require applications with respect to *natural persons* to address the following items:

- Proposed paragraph (d)(2) would require the applicant to address the associated person’s employment during the period subsequent to the issuance of the statutory disqualification. Where the associated person subject to a statutory disqualification has been employed without issue since the conduct resulting in the statutory disqualification, that fact may be relevant to the Commission’s assessment as to whether it would be consistent with the public interest for the person to effect or be involved in effecting security-based swaps on behalf of an SBS Entity.

- Proposed paragraph (d)(4) would require the applicant to describe the terms and conditions of employment and supervision to be exercised over the associated person and, where applicable, by such associated person. The Commission is proposing this

requirement so that the Commission will be able to better assess the extent to which the terms and conditions of employment and supervision may create or mitigate the risk that the associated person subject to a statutory disqualification may engage in future misconduct. Moreover, the Commission is proposing to require that the applicant describe any supervision to be exercised by the associated person because the Commission believes that there could be a greater risk of harm where an associated person that is subject to a statutory disqualification has greater supervisory responsibilities, or is supervising another person that is also subject to a statutory disqualification. In the event a prior application has been submitted with respect to the associated person, as set forth in proposed paragraph (g) to proposed Rule of Practice 194, the SBS Entity should describe in what manner the terms and conditions of employment and supervision will differ, if at all, from the supervision in any such prior application.

- Proposed paragraph (d)(5) would require the applicant to list the qualifications, experience, and disciplinary history<sup>64</sup> of the proposed supervisor(s) of the associated person. This provision is designed to assist the Commission in considering the capacity of the supervisor to oversee the associated person subject to a statutory disqualification in assessing whether the supervision of a person is likely to minimize the risk of future misconduct by the associated person. The Commission believes that the qualifications and experience of the supervisor of an associated person subject to a statutory disqualification has a bearing on the potential for future misconduct by that person.

- Proposed paragraph (d)(7) would require the applicant to list the names of any other associated persons at the SBS Entity who have previously been

<sup>64</sup> Disciplinary history would include, for example, the items contained in Exchange Act Rule 17a-3(a)(12)(i)(D)-(G), 17 CFR 240.17a-3(a)(12)(i)(D)-(G), which items are required to be collected by broker-dealers with respect to their associated persons and are required to be provided on Form U-4. Such items include, among other things, a record of any disciplinary action taken, or sanction imposed, upon the associated person by any federal or state agency, or national securities exchange or national securities association, a record of any permanent or temporary injunction entered against the associated person, or a record of any arrest or indictment for any felony or certain specified types of misdemeanors. See also Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25194, 25205, 25308-09 (May 2, 2014).

subject to a statutory disqualification, and whether they are to be supervised by the associated person. Proposed Rule of Practice 194(d)(7) is designed to assist the Commission in assessing whether there could be a greater risk of misconduct where an associated person that is subject to a statutory disqualification is working directly with or is supervising another person that is subject to a statutory disqualification.

- Proposed paragraph (d)(8) would require the applicant to address whether the associated person has taken any relevant courses, seminars, examinations or other actions subsequent to becoming subject to a statutory disqualification to prepare for his or her participation in the security-based swap business. The information provided by proposed paragraph (d)(8) would inform the Commission as to whether the associated person has taken steps to apprise himself of relevant obligations under the federal securities or other laws or regulations, and, as a result, may factor into the Commission's decision as to whether it would be consistent with the public interest for the person to effect or be involved in effecting security-based swaps on behalf of an SBS Entity.

In addition to the items discussed above, proposed paragraph (f) of the proposed rule would require applications with respect to persons that are *not natural persons* to address the following items:

- Proposed paragraph (f)(1) would require general background information about the associated person, including (i) the number of employees, (ii) the number and location of offices, (iii) the type(s) of business(es) in which the associated person is engaged; and (iv) the SRO memberships and effective dates of such membership of the associated person, if applicable. This requirement would assist the Commission in understanding the business of the associated person, including determining what SROs, if any, oversee the associated person. The Commission believes that obtaining basic background information about the firm would aid the Commission in understanding the entity that is an associated person, and therefore aid in its assessment of whether it is in the public interest to permit the associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity.

- Proposed paragraph (f)(4) would require a description of whether, with respect to the statutory disqualification and the sanctions imposed, the associated person was ordered to undertake any changes to its

organizational structure or policies and procedures set forth in proposed Rule of Practice 194(e)(4), and to the extent that such changes were mandated, to describe what changes were mandated and whether the associated person has implemented them. This proposed requirement may aid the Commission in assessing whether the applicant has made changes to mitigate the occurrence of any future conduct that may result in statutory disqualification.

#### 5. Prior Applications or Processes

Proposed paragraph (g) would require an applicant to provide as part of the application any order, notice or other applicable document reflecting the grant, denial or other disposition (including any dispositions on appeal) of any prior application concerning the associated person under proposed Rule of Practice 194 and other similar processes.<sup>65</sup> This provision is designed to inform the Commission when a similar application made with respect to the associated person has been granted or denied (or been subject to some other disposition).

Information concerning the grant or denial (or other disposition) of a prior application or other request for relief, and the reasons for the grant or denial, may be relevant to the Commission's assessment as to whether it would be consistent with the public interest for the person to effect or be involved in effecting security-based swaps on behalf of an SBS Entity. For example, in the event that a prior application has been granted, but the terms and conditions of employment with the other registrant are materially different from the SBS Entity, the Commission could consider whether the terms and conditions at the SBS Entity that are different may result in any greater risk of future misconduct. In addition, if a prior application has been denied the Commission may take into consideration the prior application or request for relief in its determination of whether permitting an associated person to effect or be involved in effecting security based swaps on behalf of the SBS Entity would be consistent with the public interest to grant an application under Rule of Practice 194. Notably, under such circumstances (*i.e.*, a denial or where the terms and conditions of employment are not the same), an SBS Entity could not avail itself of paragraph (j) of proposed Rule of Practice 194<sup>66</sup> and therefore would be required to file an application under

proposed Rule of Practice 194 in order to permit an associated person subject to a statutory disqualification to be able to effect or be involved in effecting security-based swaps on behalf of an SBS Entity.

- Proposed paragraph (g)(1) would require an applicant to provide any order, notice or other applicable document where an application has previously been made for the associated person pursuant to Rule of Practice 194.

- Proposed paragraph (g)(2) would require an applicant to provide any order, notice or other applicable document where an application has previously been made for the associated person pursuant to Rule of Practice 193.<sup>67</sup>

- Proposed paragraph (g)(3) would require an applicant to provide any order, notice or other applicable document where an application has previously been made on behalf of the associated person pursuant to Section 9(c) of the Investment Company Act of 1940 ("Investment Company Act").<sup>68</sup> Similar to proposed Rule of Practice 194, under Investment Company Act Section 9(c), any person who is ineligible under Investment Company Act Section 9(a)<sup>69</sup> may file with the Commission an application for an exemption.<sup>70</sup>

- Proposed paragraph (g)(4) would require an applicant to provide any order, notice or other applicable document where an application has previously been made on behalf of the associated person pursuant to Exchange Act Section 19(d),<sup>71</sup> Exchange Act Rule

<sup>67</sup> 17 CFR 201.193.

<sup>68</sup> 15 U.S.C. 80a-9(c).

<sup>69</sup> Under Investment Company Act Section 9(a), it is unlawful for any persons to serve or act in the capacity of employee, officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount certificate company where, among other things: (1) that person (or an affiliated person) within ten years has been convicted of any felony or misdemeanor involving the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer, investment adviser, or in other specified categories; or (2) that person (or an affiliated person), by reason of any misconduct, has been permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an underwriter, broker, dealer, investment adviser, or in other specified categories. See 15 U.S.C. 80a-9(a).

<sup>70</sup> Under Investment Company Act Section 9(c), the Commission will grant such application if it is established that: (i) the prohibition is unduly or disproportionately severe; or (ii) the conduct of such person has been such as not to make it against the public interest or protection of investors to grant such application. See 15 U.S.C. 80a-9(c).

<sup>71</sup> 15 U.S.C. 78s(d).

<sup>65</sup> In cases where a statutorily disqualified person was formerly associated with another SBS Entity, an applicant should use reasonable efforts to obtain relevant documentation from the other SBS Entity.

<sup>66</sup> See Section II.C.9, *infra*.

19h-1<sup>72</sup> or a proceeding by an SRO for a person to become or remain a member, or an associated person of a member, notwithstanding the existence of a statutory disqualification. For example, for broker-dealers, where FINRA has granted or denied an application for consent to be a member or an associated person of a member, or to continue to be a member or an associated person of a member, notwithstanding the statutory disqualification, the applicant would provide such information to the Commission in accordance with proposed paragraph (g)(4).

- Proposed paragraph (g)(5) would require an applicant to provide any order, notice or other applicable document reflecting the grant, denial or other disposition (including any dispositions on appeal) of any prior process concerning the associated person by the CFTC or a registered futures association for listing as a principal, or for registration, including as an associated person, notwithstanding the existence of a statutory disqualification. Specifically, paragraph (g)(5) would provide as follows:

- Proposed paragraph (g)(5)(i) addresses the exception in CFTC Regulation 23.22(b).<sup>73</sup> Under that provision, the CFTC allows association with a Swap Entity with respect to a person who is already listed as a principal, registered as an associated person of another CFTC registrant, or registered as a floor broker or floor trader, notwithstanding that the person is subject to a statutory disqualification under section 8a(2) or 8a(3)<sup>74</sup> of the CEA.<sup>75</sup> Under proposed paragraph (g)(5)(i), an SBS Entity would be required to provide any order or other applicable document providing that the associated person may be listed as a principal, registered as an associated person of another CFTC registrant, or registered as a floor broker or floor trader, notwithstanding the statutory disqualification.

- Proposed paragraph (g)(5)(ii) addresses the CFTC and NFA's current process for granting relief from CEA Section 4s(b)(6),<sup>76</sup> the provision that is parallel to Exchange Act Section 15F(b)(6), with respect to persons that are not exempt from that provision pursuant to CFTC Regulation 23.22(b).<sup>77</sup> Under that process, available through no-action relief granted by CFTC staff, a

Swap Entity may make an application to NFA to permit an associated person of a Swap Entity subject to a statutory disqualification to effect or be involved in effecting swaps on behalf of the Swap Entity. NFA will provide notice to a Swap Entity whether or not NFA would have granted the person registration as an associated person.<sup>78</sup> Proposed paragraph (g)(5)(ii) would require the SBS Entity to submit any determination by NFA (the sole registered futures association<sup>79</sup>) with respect to that grant of no-action relief.

#### 6. Notification to Applicant and Written Statement

Proposed paragraph (h) governs the procedure where there is an adverse recommendation proposed by the Commission staff with respect to an application under proposed Rule of Practice 194. Consistent with Rule of Practice 193(e),<sup>80</sup> proposed Rule of Practice 194(h) would provide that where there is such an adverse recommendation, the applicant shall be so advised and provided with a written statement by the Commission staff of the reasons for such recommendation.

Under proposed paragraph (h), Commission staff would be required to provide a written statement for the reasons for an adverse recommendation. Consistent with Rule of Practice 193(e),<sup>81</sup> the applicant would then have 30 days to submit to the Commission a written statement in response. This proposed provision is designed to give an applicant an opportunity to directly address an adverse recommendation by Commission staff and to assist the Commission's evaluation of applications under proposed Rule of Practice 194.

#### 7. Orders Under Proposed Rule of Practice 194

Where the Commission determines that it would be consistent with the public interest to permit the associated person of the SBS Entity to effect or be involved in effecting security-based swaps on behalf of the SBS Entity, the Commission would issue an order granting relief. Where the Commission does not or cannot make the determination that it is in the public interest to permit the associated person of the SBS Entity to effect or be involved in effecting security-based swaps on behalf of the SBS Entity, the Commission would issue an order denying the application. Orders issued

in accordance with Rule of Practice 194 would be made publicly available. Applications and supporting materials would be kept confidential subject to applicable law.<sup>82</sup>

#### 8. Temporary Exclusion for Other Persons

Proposed paragraph (i) would provide for temporary relief from the statutory prohibition in Exchange Act Section 15F(b)(6) with respect to associated persons that are not natural persons and that are subject to a statutory disqualification. Proposed paragraph (i) is designed to address the situation where an operating SBS Entity becomes subject to the statutory prohibition in Exchange Act Section 15F(b)(6)<sup>83</sup> with respect to an associated person that is not a natural person—either as a result of an associated person that effects or is involved in effecting security-based swaps on behalf of the SBS Entity becoming subject to a statutory disqualification, or as a result of a person that is subject to a statutory disqualification becoming an associated person effecting or involved in effecting security-based swaps on behalf of the SBS Entity.<sup>84</sup>

As noted in a separate release adopting registration rules for SBS Entities, the scope of the prohibition in Section 15F(b)(6) of the Exchange Act covers a wide range of actions, given the definitions of statutory disqualification and associated person, and the meaning of “involved in effecting” a security-based swap transaction, and the conduct that led to a statutory disqualification may pertain to management practices that occurred a long time ago or acts engaged in by personnel that are no longer employed by the associated person.<sup>85</sup> A commenter to the Registration Proposing Release stated that prohibiting statutorily disqualified

<sup>82</sup> However, a notice pursuant to paragraph (i)(2) to proposed Rule of Practice 194 would be made publicly available on the Commission's Web site. See Section II.C.8, *infra*.

<sup>83</sup> 15 U.S.C. 78o-10(b)(6).

<sup>84</sup> As stated in Section I.B, *supra*, the Commission has separately adopted Exchange Act Rule 15Fb6-1, 17 CFR 240.15Fb6-1, which provides that unless otherwise ordered by the Commission, an SBS Entity, when it files an application for registration as an SBS Entity, may permit a person associated with such SBS Entity that is not a natural person and that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, provided that the statutory disqualification(s) occurred prior to the compliance date set forth in the Registration Adopting Release. SBS Entities seeking to avail themselves of this provision will have to provide a list of disqualified associated entities, which will be made public by the Commission as part of the registration application.

<sup>85</sup> See Registration Adopting Release, at Section II.B.1.i.

<sup>72</sup> 17 CFR 240.19h-1.

<sup>73</sup> 17 CFR 23.22(b).

<sup>74</sup> 7 U.S.C. 12a(2), (3).

<sup>75</sup> See Note 44, *supra*.

<sup>76</sup> 7 U.S.C. 6s(b)(6).

<sup>77</sup> 17 CFR 23.22(b).

<sup>78</sup> See CFTC Staff No-Action Letter, *supra* Note 49, at 8.

<sup>79</sup> See CFTC Registration Release, 77 FR at 2624.

<sup>80</sup> 17 CFR 201.193(e).

<sup>81</sup> *Id.*

entities from effecting or being involved in effecting security-based swaps could result in “considerable” business disruptions and other ramifications.<sup>86</sup>

The Commission is concerned about the potential for business disruption to SBS Entities, and disruption to the security-based swap market, if SBS Entities engaged in the business must either cease operations, even temporarily, due to not being able to utilize the services of their associated entities, or move services to another entity that may not be as equipped to handle them pending a determination by the Commission on their application for relief under proposed Rule of Practice 194 or pending a determination by another regulator for similar relief.<sup>87</sup> Therefore, to provide for a fair and orderly process when an SBS Entity files an application with respect to associated person entities pursuant to proposed Rule of Practice 194, the Commission preliminarily believes that it is appropriate to provide a temporary exclusion, subject to certain limitations and conditions, to allow an SBS Entity to permit an associated person entity that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf pending a determination by the Commission or other regulatory body. In such cases, SBS Entities may consider implementing safeguards pending a determination by the Commission or other regulatory body to ensure that the statutory disqualification does not negatively impact upon the ability of the associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity in compliance with the applicable statutory and regulatory framework.

The Commission preliminarily believes that the approach in proposed Rule of Practice 194(i) would appropriately consider the potentially competing objectives of minimizing the likelihood for business or market disruption while maintaining strong investor protections. In particular, while the rule would provide targeted relief with respect to associated person entities, it would not provide relief with respect to associated persons who are

natural persons. The Commission believes that replacing, even temporarily, a natural person performing a particular security-based swap function would not create the same practical issues as with moving the services provided by an associated person entity to another entity.<sup>88</sup> Further, associated persons that are natural persons are the persons responsible for actually performing or overseeing the functions necessary to effect security-based swap activities. As such, the Commission preliminarily does not believe the scope of proposed Rule of Practice 194(i) should be extended to cover associated persons that are natural persons.

Under proposed paragraph (i)(1)(i), an SBS Entity would be temporarily excluded from the prohibition in Exchange Act Section 15F(b)(6) with respect to an associated person that is not a natural person (1) for 30 days following the associated person becoming subject to a statutory disqualification, or (2) 30 days following the person that is subject to a statutory disqualification becoming an associated person of an SBS Entity.<sup>89</sup> This provision is designed to provide an applicant with an initial time period to determine whether the applicant should

<sup>86</sup> For example, we believe that moving the cash and collateral management services from one entity to another would have a much more significant impact on the ability of the SBS Entity to operate than assigning a different natural person to negotiate and execute security-based swap transactions. See Registration Adopting Release, at Section II.B.1.i.

<sup>89</sup> Because a person would not become an associated person of an SBS Entity until the entity itself becomes a security-based swap dealer or a major security-based swap participant pursuant to the Commission's rules (see 17 CFR 240.3a67–8, 240.3a67–9, 240.3a71–2), proposed paragraph (i) to Rule of Practice 194 would not apply until such time as the relevant entity is first deemed to be either a security-based swap dealer or a major security-based swap participant. For example, a person whose security-based swap dealing activity crosses a *de minimis* threshold contained in Exchange Act Rule 3a71–2 (17 CFR 240.3a71–a) would not be deemed to be a security-based swap dealer until the earlier of the date on which it submits a complete application for registration pursuant to Exchange Act Section 15F(b), 15 U.S.C. 78o–10(b), or two months after the end of the month in which that person becomes no longer able to take advantage of the *de minimis* exception. Therefore, the SBS Entity would be able to rely on the temporary exclusion contained in proposed paragraph (i) to Rule of Practice 194 if the SBS Entity is associated with any entity that is subject to a statutory disqualification that effects or is involved in effecting security-based swaps on its behalf if: (1) The entity has filed a complete application with the Commission to become registered with the Commission as an SBS Entity within the time periods specified in the applicable Commission rules; and (2) the entity has filed a complete application under proposed Rule of Practice 194 within 30 days from the date on which it filed its application with the Commission to become registered as an SBS Entity.

file an application (or a notice in lieu of an application pursuant proposed paragraph (j)) with the Commission under proposed Rule of Practice 194, and to afford the applicant sufficient time to gather the materials for, draft, and file an application with respect to that associated person. The Commission preliminarily believes that allowing longer than 30 days would permit the associated person that is subject to a statutory disqualification to continue to effect or be involved in effecting security-based swaps on behalf of the SBS Entity for too long a period of time without filing an application or notice under proposed Rule of Practice 194. Moreover, the Commission believes that an SBS Entity should be able to submit an application or notice within 30 days, as the information requested should already be readily available or accessible to the SBS Entity.

Under proposed paragraph (i)(1)(ii), the SBS Entity would be excluded from the prohibition in Exchange Act Section 15F(b)(6) with respect to the associated person for 180 days following the filing of a complete application and notice pursuant to proposed Rule of Practice 194 by the SBS Entity if the application and notice is filed within the time period specified in proposed paragraph (i)(1)(i) (*i.e.*, 30 days), or until such time the Commission makes a determination on such application within the 180-day time period. The Commission preliminarily believes that 180 days should provide a sufficient maximum amount of time for the Commission to review the application, including obtaining any supplementary information from the applicant, and any recommendation by Commission staff and any response thereto by the applicant, and to make a determination on the application. The Commission anticipates that many applications under proposed Rule of Practice 194 will be instances where the Commission has not previously reviewed or acted on the underlying conduct by the associated person entity that resulted in the statutory disqualification. As such, the 180-day time period would afford the Commission a sufficient maximum amount of time to appropriately evaluate an application under proposed Rule of Practice 194.

Proposed paragraph (i)(1)(ii) does not limit the Commission from making a determination on the application prior to the expiration of the 180-day time period, and the Commission anticipates

<sup>86</sup> See 12/16/11 SIFMA Letter, at 8, Note 8, *supra*.

<sup>87</sup> Proposed Rule of Practice 194(j) provides that, subject to certain conditions, an SBS Entity may permit an associated person that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, without making an application pursuant to the proposed rule, where the Commission, CFTC, an SRO or a registered futures association has granted a prior application or otherwise granted relief from a statutory disqualification with respect to that associated person. See proposed Rule of Practice 194(j) and Section II.C.9, *infra*.

that it would do so as appropriate.<sup>90</sup> The Commission may act sooner in cases, for example, where the misconduct of an associated person is already familiar to the Commission or otherwise conducive to immediate consideration. The Commission may also need to act quickly if there are imminent concerns regarding potential investor or counterparty harm.

While we expect that most applications could be acted upon within the proposed 180-day time period, a decision could be delayed for a number of reasons, such as when an application raises complex issues associated with the Commission's determination whether to grant permanent relief from the statutory prohibition in Exchange Act Section 15F(b)(6). Proposed paragraph (i)(1)(ii) thus would address the situation where the Commission does not render a decision on the Rule of Practice 194 application within the 180-day time period. Specifically, proposed paragraph (i)(1)(ii) provides that where the Commission does not render a decision within 180 days following the filing of an application under proposed Rule of Practice 194, the SBS Entity would have 60 additional days to conform its activities to comply with the prohibition set forth in Exchange Act Section 15F(b)(6). As a result, the proposed rule would provide that if the Commission does not act on the application within 180 days, the statutory prohibition would apply.

As noted, Exchange Act Section 15F(b)(6) prohibits SBS Entities from permitting associated persons that are subject to a statutory disqualification from effecting or being involved in effecting security-based swap transactions on behalf of the SBS Entity, except to the extent otherwise provided by rule, regulation or order of the Commission. The Commission is proposing to provide in paragraph (i)(1)(ii) that, if the Commission does not act on the application within the specified time period, the statutory prohibition would apply (subject to a 60-day period to provide an SBS Entity time to conform its activities to the statutory prohibition, as discussed below). The Commission preliminarily believes that in the context of this statutory framework, the proposed time period provided for in paragraph (i)(1)(ii) is appropriately tailored. In proposing to proceed in this manner and provide a period of time for the exception from the prohibition to continue, the Commission has taken

into consideration the potential for the risk of market and business disruptions and the objective of maintaining strong investor and market protections, as discussed above. We preliminarily believe that the approach has taken into consideration these factors.<sup>91</sup> We note that it would also provide an SBS Entity certainty about the applicable process and time frames, including the 60 additional days to comply, as discussed below.

Proposed paragraph (i)(1)(ii) also would provide that where the Commission does not render a decision within 180 days, the SBS Entity would have 60 additional days to comply with the prohibition set forth in Exchange Act Section 15F(b)(6). This provision is designed to provide the applicant, where the Commission does not act on an application under proposed Rule of Practice 194 within 180 days and the SBS Entity becomes immediately subject to the statutory prohibition set forth in Exchange Act Section 15F(b)(6), sufficient time to implement any structural or other changes necessary to ensure that the SBS Entity would not have the associated person that is subject to a statutory disqualification effect or be involved in effecting security-based swaps on behalf of the SBS Entity. The 60-day time period is designed to provide the SBS Entity a sufficient amount of time to make any structural or other changes necessary to ensure compliance with the prohibition set forth in Exchange Act Section 15F(b)(6) to avoid disruption, but not so long as to continue to allow an SBS Entity to permit an associated person that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity for longer than necessary to avoid potential market or business disruptions.

Under proposed paragraph (i)(1)(iii), the SBS Entity would be excluded from the prohibition in Exchange Act Section 15F(b)(6) for a period of 180 days following the filing of a complete application with, or initiation of a process by,<sup>92</sup> the CFTC, an SRO or a registered futures association with respect to the associated person for the membership, association, registration or listing as a principal, where such application has been filed or process started prior to or within the time period specified in paragraph (i)(1)(i)

and a notice has been filed with the Commission within the time period specified in proposed paragraph (i)(1)(i). This provision is designed to provide a temporary exclusion to an SBS Entity such that an SBS Entity could avail itself of filing a notice in lieu of an application, as set forth in proposed paragraph (j), and thus would provide temporary relief to the SBS Entity from the prohibition set forth in Exchange Act Section 15F(b)(6) during the pendency of an application or process by the CFTC, an SRO or a registered futures association. As with the provisions of proposed paragraph (i)(1)(ii) with regard to the Commission's consideration of an application under proposed Rule of Practice 194, this provision is designed to address the Commission's concerns about potential market or business disruptions while the SBS Entity has an application or process pending before the CFTC, an SRO or a registered futures association with regard to the associated person subject to a statutory disqualification. The Commission preliminarily believes that 180 days should generally provide a sufficient amount of time for the CFTC, an SRO or a registered futures association to make a determination on the application, and would also be consistent with the time period proposed in paragraph (i)(1)(ii).

In addition, under proposed paragraph (i)(1)(iii), where the CFTC, an SRO or a registered futures association does not render a decision or renders an adverse decision with respect to the associated person within the 180-day time period, the SBS Entity would have 60 additional days to conform its activities to comply with the prohibition set forth in Exchange Act Section 15F(b)(6). Similar to proposed paragraph (i)(1)(ii), this provision is aimed at preventing market or business disruptions that may result from the scenario where the CFTC, an SRO or a registered futures association does not render a decision or renders an adverse decision with respect to the associated person within the 180-day time period, and the SBS Entity therefore becomes immediately subject to the statutory prohibition set forth in Exchange Act Section 15F(b)(6). The 60-day time period is designed to provide the SBS Entity a sufficient amount of time to make any structural or other necessary changes to ensure compliance with the prohibition set forth in Exchange Act Section 15F(b)(6), but not so long as to continue to allow an SBS Entity to permit an associated person that is subject to a statutory disqualification to

<sup>91</sup> See Sections V.D and E, *infra*.

<sup>92</sup> The commencement of the 180-day time period would begin at the time of filing of an application with an SRO (e.g., Form MC-400A) or the initiation of a proceeding under NFA Registration Rule 504 (e.g., a Notice of Intent to Revoke Registration) or CFTC Regulation 3.60, 17 CFR 3.60.

<sup>90</sup> The Commission expects that it will expeditiously process applications and take necessary steps to facilitate timely action.

effect or be involved in effecting security-based swaps on behalf of the SBS Entity for longer than necessary to avoid potential market or business disruptions where the CFTC, an SRO or registered futures association has not made a decision or has rendered an adverse decision within the 180-day time period.

The SBS Entity would not be able to avail itself of the temporary exclusion set forth in proposed paragraph (i)(1) in two circumstances. First, the temporary exclusion from the prohibition in Exchange Act Section 15F(b)(6) would not be available where the Commission has otherwise ordered—for example, where the Commission, by order, has censured, placed limitations on the activities or functions of the associated person, or suspended or barred such person from being associated with an SBS Entity. Second, the temporary exclusion from the prohibition in Exchange Act Section 15F(b)(6) would not be available in cases where the Commission, CFTC, an SRO or a registered futures association has previously denied membership, association, registration or listing as a principal with respect to the associated person that is the subject of the pending application. In both circumstances, the Commission, CFTC, an SRO or registered futures association will have affirmatively made a determination to not allow an associated person to participate in the financial industry. The Commission preliminarily believes that, in such cases, the SBS Entity should not be able to avail itself of the temporary exclusion with respect to the associated person because doing so would enable an associated person to participate in the security-based swap market notwithstanding that the Commission or another regulator has otherwise prohibited the associated person from participating in another sector of the financial industry.

Proposed paragraph (i)(2) would provide that an SBS Entity would be excluded from the statutory prohibition in Exchange Act Section 15F(b)(6)<sup>93</sup> as provided in proposed paragraph (i)(1)(ii) and (i)(1)(iii) only where the SBS Entity has filed (within the 30-day timeframe) a notice with the Commission setting forth the name of the SBS Entity and the name of the associated person that is subject to a statutory disqualification, and attaching as an exhibit to the notice a copy of the order or other applicable document that resulted in the associated person being subject to a statutory

disqualification.<sup>94</sup> The Commission proposes to make publicly available on its Web site the notice provided under proposed paragraph (i)(2). The Commission is proposing to require such notice to help inform market participants of the fact that an SBS Entity is availing itself of the temporary exclusion set forth in proposed paragraph (i) with respect to an associated person entity subject to a statutory disqualification that is effecting or involved in effecting security-based swaps on behalf of an SBS Entity.

The Commission is not proposing to require such notice with respect to associated persons that are natural persons, because natural persons would not be able to avail themselves of the temporary exclusion proposed in paragraph (i). As a result, a natural person that is subject to a statutory disqualification would not be permitted to effect or be involved in effecting security-based swaps on behalf of an SBS Entity while an application is pending. Additionally, where the association, registration or listing as a principal has been granted or otherwise approved with respect to an associated person that is a natural person by the Commission, CFTC, an SRO or registered futures association, notwithstanding that the associated person is subject to a statutory disqualification, such an order or other relevant document would be made publicly available,<sup>95</sup> and thus would provide information to market participants with respect to the associated person and the statutory disqualification.

Proposed paragraph (i)(3) would provide that where the Commission denies an application pursuant to proposed Rule of Practice 194 with respect to an associated person that is not a natural person, the Commission may provide by order an extension of the exclusion provided for in proposed paragraph (i)(1)(ii) as is necessary or appropriate to allow the applicant to comply with the prohibition in Exchange Act Section 15F(b)(6). Under this proposed provision, the Commission would extend the temporary exclusion provided for in proposed paragraph (i)(1)(ii) where the Commission determines that doing so is necessary or appropriate. The Commission believes that proposed paragraph (i)(3) provides the Commission with sufficient flexibility so that the Commission may determine,

based on its discretionary review of the particular facts and circumstances with respect to an application, whether or not it is necessary or appropriate to extend the temporary exclusion provided for in proposed paragraph (i)(1)(ii). For example, under certain circumstances, the Commission may determine that is necessary or appropriate to provide a certain amount of time for an SBS Entity to wind down operations with an associated person entity that is subject to a statutory disqualification in order to avoid disruptions to the security-based swaps business of the SBS Entity or to the security-based swap market. In other instances, there may not be a risk of market or business disruptions in the event that an SBS Entity is prohibited from permitting an associated person entity to effect or be involved in effecting security-based swaps on behalf of the SBS Entity. In such instances, the Commission may specify in an order denying an application under proposed Rule of Practice 194 that no extension of the exclusion provided for in proposed paragraph (i)(1)(ii) would be necessary or appropriate.

Although the Commission is proposing paragraph (i)(1) at this time, the Commission is also soliciting comment on two alternative approaches with respect to this provision. First, the Commission solicits comment on whether proposed paragraph (i)(1)(ii) should alternatively provide that, if the Commission does not render a decision within the appropriate time frame, the application shall be deemed granted. Under this alternative, the Commission would consider the extent to which providing that the application would be deemed granted if the Commission does not act in the 180-day time period would help to avoid potential market and business disruptions that may result when the temporary exclusion expires after day 180 (as opposed to providing a 60-day conformity period). The Commission would also consider how such an approach would impact counterparty and investor protection in cases where the Commission has not made a specific finding that it is consistent with the public interest to permit a statutorily disqualified associated person entity to effect or be involved in effecting security-based swaps on behalf of an SBS Entity.

Second, the Commission solicits comment on whether, alternatively, the Commission should provide an exclusion to permit an SBS Entity to allow associated person entities subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of SBS Entities. As noted in Section II.B.3, the CFTC has

<sup>94</sup> See proposed Rule of Practice 194(c)(1), (e)(1); Section II.C.3, *supra*.

<sup>95</sup> See Section II.C.7, *supra*.

<sup>93</sup> 15 U.S.C. 78o–10(b)(6).

defined associated persons of Swap Entities to be limited to natural persons,<sup>96</sup> which results in the application of Section 4s(b)(6) of the CEA<sup>97</sup> to natural persons associated with a Swap Entity (not entities). As a result, this alternative would result in consistency with the CFTC. As with the first alternative, under this alternative, the Commission would take into consideration the extent to which the approach, by providing an exclusion from the statutory prohibition in Exchange Act Section 15F(b)(6) with respect to associated person entities, would minimize potential disruptions to the business of SBS Entities that could lead to possible market disruption. The Commission would also consider how this approach, which would apply the statutory prohibition in Exchange Act Section 15F(b)(6) to associated persons that are natural persons, but not to associated person entities, would impact counterparty and investor protection.<sup>98</sup>

#### 9. Notice in Lieu of an Application

Paragraph (j) of proposed Rule of Practice 194 would limit the applicability of the prohibition in Exchange Act Section 15F(b)(6) by prescribing the conditions under which an SBS Entity may permit a person associated with it that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf without being required to file an application under Rule of Practice 194.<sup>99</sup> Generally, proposed paragraph (j) would permit associated persons that are subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of SBS Entities where the Commission or other regulatory authority previously reviewed the matter and permitted the person subject to a statutory disqualification to be a member, associated with a member, registered or listed as a principal of a regulated entity notwithstanding statutory disqualification.

Under the proposed rules, the Commission, the CFTC, an SRO or a registered futures association will have specifically reviewed the underlying basis for the statutory disqualification

and made an affirmative finding to grant or otherwise approve membership, association, registration or listing as a principal, notwithstanding the statutory disqualification. So long as the terms and conditions are adhered to in the context of the association with the SBS Entity, the Commission believes it would not be necessary for the Commission (other than in cases where the person is subject to a Commission bar) to re-examine an event for which relief has already been granted. The Commission further notes, consistent with the CFTC in adopting an analogous provision in Regulation 23.22(b),<sup>100</sup> that it would generally be anomalous for a person to be able to engage in securities transactions with members of the retail public—for example, as an associated person of a broker-dealer—but be prohibited from effecting or being involved in effecting security-based swap transactions with significantly more sophisticated clients as an associated person of a SBS Entity.

Specifically, subject to the conditions specified in proposed paragraph (j)(2), proposed Rule of Practice of Practice 194(j)(1) would provide as follows:

Proposed Rule of Practice 194(j)(1)(i) would permit a person associated with an SBS Entity that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity where the person has admitted to or continued in membership, or participation or association with a member, of an SRO, such as FINRA, notwithstanding that such person is subject to a statutory disqualification under Exchange Act Section 3(a)(39).<sup>101</sup>

Proposed Rule of Practice 194(j)(1)(ii) would permit a person associated with an SBS Entity that is a natural person and that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity where the person has been granted consent to

associate pursuant to Rule of Practice 193.<sup>102</sup> As stated in Section II.B.1, *supra*, Rule of Practice 193 provides a process by which persons that are not regulated by an SRO (*e.g.*, employees of an investment adviser, an investment company, or a transfer agent) can seek to reenter the securities industry despite previously being barred by the Commission.

Proposed Rule of Practice 194(j)(1)(iii) would permit a person associated with an SBS Entity that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity where an application has previously been granted under proposed Rule of Practice 194 with respect to the associated person. For example, proposed paragraph (j)(1)(iii) would include instances where an SBS Entity had previously received approval of an application under proposed Rule of Practice 194 with respect to an associated person, and the same person becomes an associated person of a different SBS Entity.

Proposed Rule of Practice 194(j)(1)(iv) would permit a person associated with an SBS Entity to effect or be involved in effecting security-based swaps on behalf of the SBS Entity where, notwithstanding the a statutory disqualification under CEA Sections 8a(2) or 8a(3),<sup>103</sup> the person (1) has been registered as or listed as a principal of a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity pool operator, commodity trading advisor, or leverage transaction merchant, registered as an associated person of any of the foregoing, registered as or listed as a principal of a swap dealer or major swap participant, or registered as a floor broker or floor trader, and (2) is not subject to a Commission bar pursuant to Sections 15(b), 15B, 15E, 15F or 17A of the Exchange Act (15 U.S.C. 78o(b), 78o-4, 78o-7, 78o-10, 78q-1), Section 9(b) of the Investment Company Act (15 U.S.C. 80a-9(b)) or Section 203(f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(f)). This provision is designed to exclude from scope of the statutory prohibition in Exchange Act Section 15F(b)(6) persons that have previously been permitted to be registered or listed as a principal by the CFTC or the NFA, notwithstanding that such persons are subject to a statutory disqualification, including those persons that fall within the scope of the exclusion in CFTC Regulation 23.22(b) (thereby harmonizing the approach of

<sup>96</sup> See Note 42, *supra*.

<sup>97</sup> See 7 U.S.C. 6s(b)(6).

<sup>98</sup> Moreover, although SBS Entities would be excluded from the statutory prohibition in Exchange Act Section 15F(b)(6) with respect to associated person entities under this alternative, the Commission nonetheless could, by order, censure, place limitations on the activities or functions of the associated person, or suspend or bar such person from being associated with an SBS Entity. See 15 U.S.C. 78o-10(l)(3).

<sup>99</sup> See proposed Rule of Practice 194(j).

<sup>100</sup> In adopting Regulation 23.22(b), the CFTC stated that, if it did not provide an exception as suggested, a person could be permitted to direct futures-related activities or solicit futures-related business with members of the retail public—*e.g.*, as, respectively, a principal or associated person of futures commission merchant or commodity pool operator—but that same person would be barred from soliciting, accepting, or otherwise effecting or being involved in effecting swaps transactions with significantly more sophisticated clients as an associated person of a Swap Entity. See CFTC Registration Release, 77 FR at 2615.

<sup>101</sup> See 17 CFR 240.19h-1. As discussed in Section II.B.2, *supra*, Exchange Act Rule 19h-1 prescribes the form and content, and provides for Commission review of proposals submitted by SROs to allow a member or associated person subject to a statutory disqualification to become or remain a member or associated person of a member.

<sup>102</sup> 17 CFR 201.193.

<sup>103</sup> 7 U.S.C. 12a(2), (3).

the Commission with the CFTC in that respect).<sup>104</sup> However, the provision would exclude instances where the Commission itself has made an affirmative determination to bar or suspend the associated person. In such cases, the Commission believes that it should be afforded an opportunity to review an application with regard to such barred person or during the pendency of the suspension in cases where an SBS Entity requests relief from the statutory prohibition in Exchange Act Section 15F(b)(6).<sup>105</sup>

Paragraph (j)(2) of proposed Rule of Practice 194 would set forth the conditions necessary for an SBS Entity to meet in order to permit an associated person that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity. An SBS Entity seeking to rely on proposed Rule of Practice 194(j)(1) would have to meet all of the conditions specified in proposed paragraph (j)(2).

Under proposed paragraph (j)(2)(i), all matters giving rise to a statutory disqualification under Exchange Act Section 3(a)(39)(A) through (F) must have been subject to an application or process where the membership, association, registration or listing as a principal has been granted or otherwise approved by the Commission, CFTC, an SRO or registered futures association. This provision is designed to ensure that either the Commission, CFTC, an SRO (*e.g.*, FINRA) or a registered futures association (*i.e.*, NFA) has specifically reviewed the underlying basis for each and every statutory disqualification under Exchange Act Section 3(a)(39)(A) through (F),<sup>106</sup> and made an affirmative finding to permit or continue the membership, association, registration or listing as a principal, notwithstanding the statutory disqualification. For example, the mere fact that an associated person is permitted to effect or be involved in effecting swaps on behalf of a Swap Entity because of the applicability of the exclusion in CFTC Regulation 23.22(b) would not, by itself, allow the associated person of the SBS

Entity to effect or be involved in effecting security-based swaps on its behalf. Rather, the CFTC or NFA must have reviewed all matters giving rise to a statutory disqualification for purposes of Exchange Act Section 3(a)(39)(A) through (F).<sup>107</sup> The Commission believes that it is consistent with investor protection to provide an exclusion for an SBS Entity from the statutory prohibition in Exchange Act Section 15F(b)(6) where an appropriate regulatory authority has previously affirmatively considered and granted relief with respect to the conduct underlying each statutory disqualification of an associated person of the SBS Entity.

Proposed Rule of Practice 194(j)(2)(ii) would provide that an SBS Entity may permit a person associated with it that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, without filing an application under proposed Rule of Practice 194, only where the terms and conditions of the association with the SBS Entity are the same in all material respects as those approved in connection with the prior order, notice or other applicable document granting the membership, association, registration or listing as a principal provided for in paragraph (j)(1). In short, to obtain relief from the statutory prohibition in Exchange Act Section 15F(b)(6), the associated person of the SBS Entity must be subject to the same terms and conditions—including, for example, supervisory requirements—as those previously imposed by the agency, an SRO or a registered future association (*i.e.*, the Commission, CFTC, NFA or SRO).<sup>108</sup>

The Commission is proposing this provision so that an associated person subject to a statutory disqualification remains subject to the same terms and conditions with respect to the SBS Entity. For example, where relief previously granted by FINRA includes specific supervisory requirements following an eligibility proceeding, but a person is not subject to the same requirements by the SBS Entity, the Commission believes that it should review whether the terms and conditions of the association with the SBS Entity are appropriate under an application under proposed Rule of Practice 194.

<sup>107</sup> For example, an associated person of an SBS Entity could potentially be subject to a statutory disqualification for purposes of Exchange Act Section 3(a)(39)(A) through (F), but not for purposes of CEA Section 8a(2) or (3). Compare 15 U.S.C. 78c(a)(39)(A)–(F), 7 U.S.C. 12a(2), (3).

<sup>108</sup> See also, *e.g.*, Exchange Act Rule 19h–1(a)(3)(i), 17 CFR 240.19h–1(a)(3)(i).

Proposed Rule of Practice 194(j)(2)(iii) would provide that, where an SBS Entity seeks for an associated person that is a natural person to be permitted to effect or be involved in effecting security-based swaps on behalf of the SBS Entity without filing an application pursuant to proposed Rule of Practice 194(j), the SBS Entity would be required to file a notice with the Commission. Specifically, proposed Rule of Practice 194(j)(2)(iii) would require the following information in the notice:

- The name of the SBS Entity;<sup>109</sup>
- The name of the associated person subject to a statutory disqualification;<sup>110</sup>
- The name of the associated person's prospective supervisor(s) at the SBS Entity;<sup>111</sup>
- The place of employment for the associated person subject to a statutory disqualification;<sup>112</sup> and
- The identity of any agency, SRO or registered futures association that has indicated its agreement with the terms and conditions of the proposed association, registration or listing as a principal.<sup>113</sup>

The Commission believes that the information requested by the notice under proposed paragraphs (j)(2)(iii) would aid the Commission and its staff in assessing risk at SBS Entities, including for examination purposes. By knowing the name of the SBS Entity, name and location of the associated person subject to a statutory disqualification, and the name of the supervisor of the associated person, the Commission will obtain information that may be useful for examination purposes, such as determining whether to examine a particular SBS Entity and whom to speak to at the SBS Entity. The identity of an agency, SRO or registered futures association that has indicated its agreement with the terms and conditions of the proposed association could be useful to the Commission because the Commission staff could use the information to confer with or seek information from that agency, SRO or registered futures association, if necessary.

Proposed Rule of Practice 194(j)(2)(iv) would provide that, where an SBS Entity seeks for an associated person that is not a natural person to be permitted to effect or be involved in effecting security-based swaps on behalf of the SBS Entity without filing an application pursuant to proposed Rule

<sup>104</sup> See Sections II.B.3 and II.C.5, *supra*, concerning CFTC Regulation 23.22(b), 17 CFR 23.22(b). Under the proposed rule, such relief would not be available in cases where a registered futures association has made a determination that, had the associated person applied for registration as an associated person of an SBS Entity, notwithstanding a statutory disqualification, the application would have been granted. See CFTC Staff No-Action Letter, *supra* Note 49, at 5–8.

<sup>105</sup> A suspension remains in effect for a period not exceeding twelve months. Once the suspension is lifted, the person is not deemed to be subject to a statutory disqualification, and thus would not need to apply to the Commission to reassociate.

<sup>106</sup> 15 U.S.C. 78c(a)(39)(A)–(F).

<sup>109</sup> See proposed Rule of Practice 194(j)(2)(iii)(A).

<sup>110</sup> See proposed Rule of Practice 194(j)(2)(iii)(B).

<sup>111</sup> See proposed Rule of Practice 194(j)(2)(iii)(C).

<sup>112</sup> See proposed Rule of Practice 194(j)(2)(iii)(D).

<sup>113</sup> See proposed Rule of Practice 194(j)(2)(iii)(E).

of Practice 194(j), the SBS Entity would be required to file a notice with the Commission. Specifically, proposed Rule of Practice 194(j)(2)(iv), would require the following information in the notice:

- The name of the SBS Entity;<sup>114</sup>
- The name of the associated person that is subject to a statutory disqualification;<sup>115</sup> and
- The identification of any agency, SRO or a registered futures association that has indicated its agreement with the terms and conditions of the proposed association, registration or listing as a principal.<sup>116</sup>

The Commission believes that knowing the name of the statutorily disqualified associated person would aid the Commission and its staff in assessing risk at SBS Entities, including for examination purposes. Additionally, the identity of an agency, SRO or registered futures association that has indicated its agreement with the terms and conditions of the proposed association could be useful to the Commission because the Commission staff could use the information to confer with or seek information from that agency, SRO or registered futures association, if necessary.

#### 10. Note to Proposed Rule of Practice 194

The proposed Note, which is similar to the Preliminary Note to Rule of Practice 193, is designed to advise applicants of the importance of having adequate supervision in place at the SBS Entity so as to minimize the risk of subsequent occurrences of misconduct.

In particular, the Note to proposed Rule of Practice 194 would provide that:

- An application made pursuant to the rule must show that it would be consistent with the public interest to permit the associated person of the SBS Entity to effect or be involved in effecting security-based swaps on behalf of the SBS Entity.<sup>117</sup>

- The nature of the supervision that an associated person will receive or exercise as an associated person with a registered entity is an important matter bearing upon the public interest. The Commission believes that this statement would inform applicants that associated persons that are subject to a statutory disqualification should have adequate supervision so as to prevent potential future harm to counterparties, SBS Entities themselves, or other persons. The Commission would generally be

less likely to issue an order granting relief under Rule of Practice 194 where the associated person subject to a statutory disqualification is not subject to adequate supervision.<sup>118</sup> Second, there may be an increased risk of harm to counterparties, the SBS Entity and other market participants where the associated person subject to a statutory disqualification supervises other persons—in particular, where the supervision is over other persons that are also subject to a statutory disqualification.

- In meeting the burden of showing that permitting the associated person to effect or be involved in effecting security based swaps on behalf of the SBS Entity is consistent with the public interest, the application and supporting documentation must demonstrate that the terms or conditions of association, procedures, or proposed supervision (if the associated person is a natural person), are reasonably designed to ensure that the statutory disqualification does not negatively impact upon the ability of the associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity in compliance with the applicable statutory and regulatory framework. The Commission is proposing to include this statement to advise applicants of the importance of these items to the Commission's consideration of whether to grant relief.

- Normally, the applicant's burden of demonstrating that permitting the associated person to effect or be involved in effecting security based swaps on behalf of the SBS Entity is consistent with the public interest will be difficult to meet where the associated person is to be supervised by, or is to supervise, another statutorily disqualified individual. The Commission is proposing to include this statement because the Commission believes that there may be a greater risk of harm where a person that is subject to a statutory disqualification is

supervising another person that is subject to a statutory disqualification.

- Where the associated person wishes to become the sole proprietor of a registered entity and thus is seeking that the Commission issue an order permitting the associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of an SBS Entity notwithstanding an absence of supervision, the applicant's burden will be difficult to meet. The Commission is proposing to include this statement because, as stated, the Commission believes that there is a greater risk of harm where the associated person subject to a statutory disqualification is not subject to adequate supervision.

- The associated person may be limited to association in a specified capacity with a particular registered entity and may also be subject to specific terms and conditions. The Commission is proposing to include this statement to advise applicants that the Commission may consider whether to impose limitations on permitting an associated person subject to a statutory disqualification to effect or be involved in effecting security-based swap transactions on behalf of an SBS Entity. Those terms and conditions may concern, for example, heightened supervisory conditions or other procedures with respect to the associated person subject to a statutory disqualification.

Finally, the proposed Note discusses various procedural aspects of proposed Rule of Practice 194, including the following:

- In addition to the information specifically required by the rule, applications with respect to natural persons should be supplemented, where appropriate, by written statements of individuals who are competent to attest to the associated person's character, employment performance, and other relevant information. This statement is designed to encourage applicants to provide written statements from individuals other than the applicant and the associated person, to help the Commission better assess whether issuing an order granting relief under proposed Rule of Practice 194 is consistent with the public interest.

- In addition to the information required by the rule, the Commission staff may request additional information to assist in the Commission's review. This statement is designed to inform applicants that the Commission staff may request additional information beyond that provided by the SBS Entity in its application. For example, where

<sup>114</sup> See proposed Rule of Practice 194(j)(2)(iv)(A).

<sup>115</sup> See proposed Rule of Practice 194(j)(2)(iv)(B).

<sup>116</sup> See proposed Rule of Practice 194(j)(2)(iv)(C).

<sup>117</sup> See Section ILC.2, *supra*.

<sup>118</sup> See *In the Matter of Shupack*, Investment Advisers Act Release No. 1061 (Mar. 23, 1987), 48 SEC. 697, 700-01 (1987) ("In light of Shupack's record, including the misrepresentation contained in his original Rule 29 [the predecessor to Rule of Practice 193] application, we conclude that he should not be allowed to re-enter the advisory field when no effective supervision would be exercised over his activities."); *In the Matter of Sample*, Investment Advisers Act Release No. 4021, 2015 SEC LEXIS 466, at \*8 (Feb. 4, 2015) (Division of Enforcement, pursuant to delegated authority, rejecting application under Rule of Practice 193 where "[t]he supervision proposed in the application appears to be no different from that exercised over [the barred person] during his prior association with [the registered investment adviser]").

the information contained in an application raises additional questions regarding the nature of the conduct resulting in the statutory disqualification, the capacity or position of the associated person, or the terms and conditions of the association with the SBS Entity, the Commission staff may request additional information to assist in the review of the pending application.

- Intentional misstatements or omissions of fact may constitute criminal violations of 18 U.S.C. 1001, *et seq.* and other provisions of law. This proposed statement is designed to help ensure that the Commission receives accurate information in connection with an application under Proposed Rule of Practice 194. In addition, providing a misstatement in an application would weigh against a finding that providing relief by the Commission under Rule of Practice 194 would be consistent with the public interest.

- The Commission will not consider any application that attempts to reargue or collaterally attack the findings that resulted in the statutory disqualification. This statement is designed to advise applicants that Rule of Practice 194 may not be used as an appeals process for the underlying findings. The Commission notes there are other appropriate avenues for challenging decisions.

### III. Request for Comment

The Commission is requesting comment regarding all aspects of proposed Rule of Practice 194, including any investor protection or other concerns. The Commission particularly requests comment from entities that intend to register as SBS Entities and that anticipate making an application under proposed Rule of Practice 194, were it to be adopted, as well as counterparties to such SBS Entities. This information will help inform the Commission's consideration of the appropriate process through which SBS Entities could seek relief from the prohibition in Exchange Act Section 15F(b)(6).<sup>119</sup>

The Commission also seeks comment on the particular questions below. The Commission will carefully consider all comments and information received, and will benefit especially from detailed responses.

Q-1. Is it necessary for the Commission to have a rule that specifies the process, such as that proposed in Rule of Practice 194, for SBS Entities to seek relief for their associated persons who are subject to a statutory

disqualification to effect or be involved in effecting security-based swaps? Why or why not?

Q-2. How many SBS Entities are likely to submit applications pursuant to the proposed rule? Please specify the number of applications that would likely relate to an associated person that is a natural person versus an entity.

Q-3. Should the Commission make its determination based on whether it would be consistent with the public interest to permit the person associated with the SBS Entity who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity? Should the Commission adopt a different standard of review? If so, what should it be, and why?

Q-4. Should the Commission look to Rule of Practice 193 and FINRA Forms MC-400 and MC-400A in establishing the form of application in proposed Rule of Practice 194? Please explain why or why not. In addition, if the Commission should not model the proposed rule on Rule of Practice 193 or FINRA Forms MC-400 and MC-400A, what alternatives (if any) should the Commission consider and why?

Q-5. Is the information requested in proposed Rule of Practice 194(c) for natural persons appropriate? Should the Commission request any additional information? If so, what items? Please explain the reasons for excluding any information or including any additional information, as well as the costs and benefits of doing so.

Q-6. With respect to the requirement in proposed Rule of Practice 194(c)(1) and (e)(1) to provide a copy of the order or other applicable document that resulted in the associated person being subject to a statutory disqualification, is there information other than that which would be contained in such order or other applicable document that the Commission should require the applicant to provide (*e.g.*, the record from an underlying proceeding resulting in a statutory disqualification)? If so, please specify what additional information and the reasons for including such information.

Q-7. Proposed Rule of Practice 194(c)(4) and (e)(5) require a copy of a decision, order or other document issued other than with respect to a proceeding resulting in the imposition of disciplinary sanctions or pending proceeding against the associated person issued by a court, state agency, agency, SRO or foreign financial regulator. Is there additional information other than that which would be contained in such documents that the Commission should require the

applicant to provide? If so, in what instances? Should the Commission not require documents issued in connection with pending proceedings (*e.g.*, orders instituting proceedings, indictments, informations and other similar documents)?

Q-8. With respect to the requirement in proposed Rule of Practice 194(c)(4) and (e)(5), is five years an appropriate time period with respect to requiring a copy of any decision, order, or document issued by a court, state agency, agency, SRO or foreign financial regulator? Should the Commission require a different time period? If so, please explain why.

Q-9. Are the items required to be addressed by proposed Rule of Practice 194(d) for natural persons appropriate? Should the Commission require that additional items be addressed? If so, what additional items? Please explain the reasons for excluding any item or including any additional item, as well as the costs and benefits of doing so.

Q-10. With respect to the requirement in proposed Rule of Practice 194(d)(6) and (f)(6), should the Commission require the compliance and disciplinary history during the five years preceding the filing of the application of the SBS Entity? Should the Commission limit the requirement, for example, by requiring only the compliance and disciplinary history of an office or location of an SBS Entity?

Q-11. With respect to the requirement in proposed Rule of Practice 194(d)(6) and (f)(6), is five years an appropriate time period with respect to the compliance and disciplinary history of the SBS Entity? Should the Commission require a different time period? If so, please explain why.

Q-12. With respect to the requirement in proposed Rule of Practice 194(d)(10) and (f)(7), is five years an appropriate time period with respect to litigation or unsatisfied judgments concerning investment or investment-related activities? Should the Commission require a different time period? If so, please explain why. Should the request for information with respect to litigation or unsatisfied judgments be limited to those concerning investment or investment-related activities? Should the request for information with respect to litigation or unsatisfied judgments be expanded to those concerning swaps or other financial instruments? If so, please explain why.

Q-13. Are the items requested in proposed Rule of Practice 194(e) for entities appropriate? For example, should the Commission request organizational charts of an associated person entity under proposed paragraph

<sup>119</sup> 15 U.S.C. 78o-10(b)(6).

(e)(3)? Should the Commission request any additional information? If so, what items? Please explain the reasons for excluding any item or including any additional information, as well as the costs and benefits of doing so.

Q-14. Are the items to be addressed in proposed Rule of Practice 194(f) for entities appropriate? Should the Commission request that any additional items be addressed? If so, what additional items? Please explain the reasons for excluding any item or including any additional item, as well as the costs and benefits of doing so.

Q-15. Should the Commission request information regarding prior applications or processes concerning the associated person, as proposed in Rule of Practice 194(g)? If not, why not? Are there any other prior applications or processes concerning associated persons that are relevant that the Commission should request? Proposed paragraph (g) requests information regarding prior applications or processes with respect to market intermediaries, such as broker-dealers. Should the Commission request information regarding prior applications or processes with respect to other types of persons, such as issuers?

Q-16. Are there any restrictions (*e.g.*, state or foreign law) on SBS Entities providing any of the information required to be provided in connection with an application under proposed Rule of Practice 194? If so, please identify the specific restrictions and the potential impact of those restrictions.

Q-17. Is the process set forth in proposed Rule of Practice 194(h) appropriate? Does 30 days provide a sufficient time to provide a written statement in response to a notice of an adverse recommendation by Commission staff? Should the time period set forth in proposed paragraph (h) (30 days for a response by the applicant) be shorter or longer, and, if so, why?

Q-18. Should the Commission provide the temporary exclusion set forth in proposed Rule of Practice 194(i)(1)? Does the temporary exclusion set forth in proposed paragraph (i) adequately consider the interest in providing regulatory certainty and addressing concerns about potential investor or counterparty harm? Is it consistent with the Commission's investor protection mandate? Is it consistent with the Commission's mandates to maintain fair, orderly, and efficient markets and facilitate capital formation? Should the temporary exclusion be modified in any way? If so, please explain how the temporary exclusion should be modified and the benefits and costs of such an approach.

For example, should the temporary exclusion be applicable only to associated persons that are not natural persons, as proposed, should it also be applicable to associated persons that are natural persons, or should the temporary exclusion not be provided to any associated person at all?

Q-19. Should the Commission provide for an exclusion from the prohibition in Exchange Act Section 15F(b)(6) with respect to associated person entities for 30 days following the associated person becoming subject to a statutory disqualification or 30 days following the person that is subject to a statutory disqualification becoming an associated person of an SBS Entity, as set forth in proposed Rule of Practice 194(i)(1)(i)?

Q-20. Should the Commission apply the temporary exclusion in proposed paragraph (i)(1) with respect to both filings made within 30 days of an associated person becoming subject to a statutory disqualification and those made within 30 days of a person that is subject to a statutory disqualification becoming an associated person of an SBS Entity?

Q-21. Does 30 days provide a sufficient time period to file an application pursuant to proposed Rule of Practice 194 such that an entity may be able to avail itself of the temporary exclusion set forth in proposed Rule of Practice 194(i)(1)(ii) or (iii)? Should the Commission provide for a process by which an applicant can submit a request for an extension of time? For example, where good cause is shown, should the Commission or its staff be able to extend the 30-day time period provided for in proposed Rule of Practice 194(i)(1) upon request by an SBS Entity? If so, during the time period for consideration of that request, should the SBS Entity be temporarily excluded from the prohibition in Exchange Act Section 15F(b)(6)?

Q-22. As proposed in paragraph (i)(1)(ii), should the Commission provide that an SBS Entity would be excluded from the prohibition in Exchange Act Section 15F(b)(6) for 180 days following the filing of a complete application pursuant to proposed Rule of Practice 194 by an SBS Entity if the application is filed within the time period specified in proposed paragraph (i)(1)(i) (*i.e.*, 30 days)? If so, why; if not, why not. If so, is the proposed 180-day time period set forth in proposed paragraph (i)(1)(ii) a reasonable time period for the Commission to appropriately evaluate an application under proposed Rule of Practice 194? Should it be shorter or longer, and, if so, why? For example, should proposed

paragraph (i)(1)(ii) instead require that the Commission act on an application within fewer days (*e.g.*, 45 or 60 days), with an option for the Commission to extend the temporary exclusion by additional days (*e.g.*, 120 or 135 days), if necessary? Alternatively, should the time period afford the Commission additional time to evaluate an application (*e.g.*, 210 or 270 days)? Or should the rule not specify a time period and provide that the temporary exclusion will remain in effect during the pendency of the Commission's review of an application under proposed Rule of Practice 194? Do commenters believe that there are circumstances in which the Commission's decision may be delayed beyond 180 days such that the time period should be extended? Should the Commission consider adopting any additional procedures or measures to promote timely consideration of applications?

Q-23. As proposed, if the Commission does not render a decision on the application within 180 days, the temporary exclusion expires and the SBS Entity becomes subject to the statutory prohibition in Exchange Act Section 15F(b)(6). As an alternative, as discussed above in Section II.C.8, should the Commission provide that where the Commission does not render a decision within 180 days following the filing of a complete application pursuant to proposed Rule of Practice 194, the application shall be deemed granted? Please explain why, as well as the costs and the benefits of this alternative approach.

Q-24. Proposed paragraph (i)(1)(iii) provides that an SBS Entity would be excluded from the prohibition in Exchange Act Section 15F(b)(6) for 180 days following the filing of a complete application with, or initiation of a process by, the CFTC, an SRO or a registered futures association with respect to an application or process with respect to the associated person for the membership, association, registration or listing as a principal, where such application has been filed or process started prior to or within the time period specified in paragraph (i)(1)(i) (*i.e.*, 30 days). Is the proposed 180-day time period set forth in proposed paragraph (i)(1)(iii) an appropriate time period for an SBS Entity to determine whether it needs to file an application pursuant to proposed Rule of Practice 194 or a notice pursuant to proposed Rule of Practice 194(j) (see Question 33, *infra*)? Should it be shorter or longer (*e.g.*, the length of the proceeding), and, if so, why? What would be the impact of having a 180-day time period? For

example, does the 180-day time period provide a sufficient amount of time for the CFTC, an SRO or a registered futures association to make a determination with respect to membership, association, registration or listing as a principal with respect to a statutorily disqualified associated person entity? Why or why not? Would SBS Entities seek to file applications under proposed Rule of Practice 194 when there is a parallel application pending with the CFTC, an SRO or registered futures association because of the risk that a decision will not be rendered by the CFTC, an SRO or registered futures association within 180 days? If so, how should such parallel applications (and determinations with respect to such applications) be addressed, including any potential inconsistencies in substance or timing between the two?

Q-25. Should the proposed rule provide for either of the 60-day time periods set forth in proposed paragraph (i)(1)(ii) and (iii) to comply to the prohibition set forth in Exchange Act Section 15F(b)(6)? If so, why; if not, why not. Should the Commission provide for a process by which an applicant can submit a request for an extension of time of these time periods? For example, where good cause is shown, should the rule specify that the Commission or its staff may extend the 60-day time period provided for in proposed Rule of Practice 194(i)(1)(ii) and (iii) upon request by an SBS Entity? If so, during the time period for consideration of such request, should the SBS Entity be temporarily excluded from the prohibition in Exchange Act Section 15F(b)(6)?

Q-26. Should the Commission, as proposed in paragraph (i)(2), require that an SBS Entity file a notice with the Commission setting forth the name of the SBS Entity, the name of the associated person that is subject to a statutory disqualification, and attaching as an exhibit to the notice a copy of the order or other applicable document that resulted in the associated person being subject to a statutory disqualification in order to qualify for the temporary exclusion provided in proposed paragraph (i)(1)(ii) and (i)(1)(iii)? Should any information be included or excluded from the notice? If so, please specify what information should be included or excluded.

Q-27. Should the notice required under proposed paragraph (i)(2) be made public? Why or why not? Should any additional information be made public, such as the application and any corresponding exhibits required under proposed paragraphs (c) through (g)?

Q-28. Should the Commission provide that, where the Commission denies an application with respect to an associated person entity, the Commission may provide by order an extension of the temporary exclusion as is necessary or appropriate to allow the applicant to comply with the prohibition in Exchange Act Section 15F(b)(6), as set forth in proposed paragraph (i)(3)? Should the Commission provide by rule a limitation on the maximum time period allowed for any such extension?

Q-29. In addition to providing the Commission with the ability to extend the temporary exclusion when the Commission denies an application, as proposed paragraph (i)(3), should the Commission specify a minimum period of time for such an extension of the temporary exclusion following the issuance of an adverse decision (e.g., 30 or 60 days following an adverse decision)? If so, please explain what minimum time period and why.

Q-30. As noted in Section II.B.3, the CFTC rules provide that associated persons of swap dealers and major swap participants are natural persons.<sup>120</sup> As a result, the prohibition in Section 4s(b)(6) of the CEA<sup>121</sup> applies to natural persons associated with a Swap Entity, but not entities associated with the Swap Entity. As discussed above in Section II.C.8, should the Commission similarly limit the scope of the statutory prohibition set forth in Exchange Act Section 15F(b)(6) to natural persons associated with an SBS Entity, beyond the parameters set forth in Exchange Act Rule 15Fb6-1? For example, should the Commission provide, by rule, that an SBS Entity may permit an associated person that is not a natural person that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, without making an application under proposed Rule of Practice 194? What would be the comparative advantages, disadvantages, costs and/or benefits of such an approach?

Q-31. If the prohibition set forth in Exchange Act Section 15F(b)(6) were limited to natural persons associated with an SBS Entity, what would be the impact on SBS Entities, counterparties and other market participants? For example, what would be the impact, if any, on the legal and compliance burden on SBS Entities (including any restructuring costs)? What would be the impact, if any, on counterparties' evaluation of the risk of entering into security-based swaps with an SBS

Entity that had associated person entities subject to a statutory disqualification? What would be the impact on investor protections and the fair and orderly operation of the security-based swap market?

Q-32. If the prohibition set forth in Exchange Act Section 15F(b)(6) were limited to natural persons associated with an SBS Entity, should the Commission require that an SBS Entity provide a notice to the Commission that would set forth the name of the associated person entity that is subject to a statutory disqualification? Why or why not? What information should any such notice contain or attach (e.g., a copy of the order or other applicable document that resulted in the associated person entity being subject to a statutory disqualification)? Should any such notice be made publicly available? What would be the comparative advantages, disadvantages, costs and benefits of providing such a notice to the public?

Q-33. Proposed paragraph (j) would, in part, permit associated persons that are subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of SBS Entities, without making an application pursuant to the proposed rule, in cases where another regulatory authority (i.e., the CFTC, an SRO or registered futures association) has specifically reviewed the underlying basis for the statutory disqualification and made an affirmative finding, notwithstanding the statutory disqualification. Should the Commission adopt this approach? Why or why not? What would be the comparative advantages, disadvantages, costs and/or benefits of adopting such an approach? For example, how should the Commission consider the impact of such an approach in circumstances where the Commission has not itself reviewed the facts giving rise to the statutory disqualification, nor the steps taken by the SBS Entity with respect to assuring sufficient oversight of the associated person?

Q-34. As an alternative, except with regard to cases where the Commission has previously granted relief under the Commission's Rule of Practice 193 or proposed Rule of Practice 194, should the Commission remove the approach outlined in proposed Rule of Practice 194(j), and require the Commission to make the relevant determination to permit an associated person that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of an SBS Entity?

Q-35. Should proposed Rule of Practice 194(j) be limited to only

<sup>120</sup> See Note 42, *supra*.

<sup>121</sup> See 7 U.S.C. 6s(b)(6).

associated persons that are natural persons? If so, please explain why.

Q-36. Should proposed Rule of Practice 194(j) be limited to only associated persons that are not natural persons (*i.e.*, entities)? If so, please explain why.

Q-37. If the Commission were to provide an exclusion from the prohibition in Exchange Act Section 15F(b)(6) where another regulatory authority has previously made an affirmative finding with respect to the statutory disqualification as proposed in paragraph (j)(1)(i) and (iv), what regulatory authorities should be included in the scope of such a rule? For example, should the Commission limit proposed Rule of Practice 194(j) only to persons that have been admitted to or continued in membership, or participation or association with a member, of a national securities association (*i.e.*, FINRA)? Or should the Commission include as proposed other SROs, the CFTC or a registered futures association? What would be the comparative advantages, disadvantages, costs and/or benefits of any such approach? Should the Commission only provide an exclusion where the CFTC, an SRO or a registered futures association has made a determination with respect to an associated person that is not registered with the Commission?

Q-38. Should the exclusion from the statutory prohibition in Exchange Act Section 15F(b)(6) where another regulatory authority has previously made an affirmative finding, as provided in proposed Rule of Practice 194(j)(1)(i) and (iv), be limited only to certain types of conduct resulting in a statutory disqualification (*e.g.*, conduct that is not investment-related and certain other conduct)?

Q-39. Should the Commission exclude from the scope of Exchange Act Section 15F(b)(6), as proposed in paragraph (j)(1)(iv), a CFTC registrant notwithstanding that the person is subject to a statutory disqualification under CEA Sections 8a(2) or 8a(3)? Are there any categories of CFTC registrants that the Commission should not exclude? If so, please explain why.

Q-40. Should the Commission exclude from the scope of the prohibition in Exchange Act Section 15F(b)(6) associated persons whom NFA has determined pursuant to the CFTC Staff No-Action Letter<sup>122</sup> that, had the associated person applied for registration as an associated person of a swap dealer or a major swap participant, notwithstanding statutory disqualification, the application would

have been granted? If so, please explain why.

Q-41. Under proposed Rule of Practice 194(j), are there any other types of registrants or persons that the Commission should exclude from the statutory prohibition in Exchange Act Section 15F(b)(6)? For example, should the Commission exclude any persons associated with an entity regulated by a prudential regulator or a foreign financial regulatory authority where the prudential regulator or foreign financial regulatory authority has previously granted relief with respect to the statutory disqualification? If so, please specify the regulator, and explain how the process that regulator uses to assess an associated person subject to a statutory disqualification is comparable to the applications or processes covered by proposed Rule of Practice 194(j).

Q-42. Under proposed Rule of Practice 194(j), are there any additional categories of associated persons of SBS Entities that the Commission should exclude from the statutory prohibition in Exchange Act Section 15F(b)(6)? If so, please provide the additional category and provide the reasons for including the category.

Q-43. As proposed in paragraph (j)(1)(ii), should the Commission allow SBS Entities to permit associated persons that are natural persons that are subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity, without making an application pursuant to the proposed rule, in cases where the natural person has been permitted to associate pursuant to the Rule of Practice 193? If so, why; if not, why not?

Q-44. As proposed in paragraph (j)(1)(iii), should the Commission allow SBS Entities to permit associated persons (natural persons and entities) that are subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity, without making an application pursuant to the proposed rule, in cases where the person has previously been permitted to effect or be involved in effecting security-based swaps on behalf of the SBS Entity pursuant to the Rule of Practice 194? If so, why; if not, why not?

Q-45. As proposed, for the exclusion in proposed Rule of Practice 194(j) to apply, should the Commission require that all matters giving rise to a statutory disqualification under Exchange Act Section 3(a)(39)(A) through (F) must have been subject to a process where the membership, association, registration or listing as a principal has been granted or otherwise approved? If so, please

explain why. Should proposed Rule of Practice 194 address the scenario where there were prior applications or processes arising from the same matter resulting in statutory disqualification, but where one application was denied while the other one was granted? For example, should the event that is later in time control whether the Commission should permit the person subject to a statutory disqualification to effect or be involved in effecting security-based swap transactions? If so, please explain why.

Q-46. For the exclusion in proposed Rule of Practice 194(j) to apply, should the Commission require that the terms and conditions of the association with the SBS Entity be the same in all material respects as those approved in connection with a previous order, notice or other applicable document granting the membership, association, registration or listing as a principal, as set forth in proposed Rule of Practice 194(j)(2)(ii)? If so, why; if not, why not?

Q-47. For the exclusion in proposed Rule of Practice 194(j) to apply, should the Commission require the notice set forth in proposed Rule of Practice 194(j)(2)(iii) and (iv)? If so, why; if not, why not? Should the Commission require any additional information in either notice? Are there any categories of information in either notice that the Commission should exclude? If so, please provide the category and the reasons for excluding it. Should the Commission adopt a different format for either notice, such as a form? If so, please explain why and provide a description of the format for the notice. Should the notice required under proposed paragraph (j)(2)(iii) and (iv) be made public? Why or why not?

Q-48. With respect to associated person entities, should the scope of proposed Rule of Practice 194(j) be limited to entities that have previously been granted relief under proposed Rule of Practice 194, as set forth in proposed paragraph (j)(1)(iii)? Should the Commission exclude from the scope of proposed Rule of Practice 194(j) entities that have previously been granted relief under another process (*e.g.*, entities granted relief by the CFTC, an SRO or NFA)?

Q-49. Should the Commission have a different process with respect to associated persons that are subject to a statutory disqualification as a result of certain types of conduct (*e.g.*, conduct that is not investment-related)? If so, please specify what process and the reasons for such an approach. Should the Commission exclude from the scope of the statutory prohibition in Exchange Act Section 15F(b)(6) any types of

<sup>122</sup> See Note 49, *supra*, at 5-8.

statutory disqualifications that are not investment-related?

#### IV. Paperwork Reduction Act

Proposed Rule of Practice 194 contains “collection of information requirements” within the meaning of the Paperwork Reduction Act of 1995 (“PRA”). The Commission has submitted the information to the Office of Management and Budget (“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 current valid control number. The title of this collection is “Rule of Practice 194.” OMB has not yet assigned a Control Number for this collection. The collections of information required by Rule of Practice 194 would be necessary for an SBS Entity to seek relief pursuant to the proposed rule or to rely on the exception in the rule for associated persons.

##### A. Summary of Collection of Information

Proposed Rule of Practice 194 would provide a process by which an SBS Entity could apply for Commission for an order permitting an associated person to effect or be involved in effecting security-based swaps on behalf of the SBS Entity notwithstanding a statutory disqualification. To make an application under proposed Rule of Practice 194, the SBS Entity filing an application with respect to an associated person that is a natural person would provide to the Commission:

- Exhibits required by proposed paragraph (c) to Rule of Practice 194, including a copy of the order or other applicable document that resulted in the associated person being subject to a statutory disqualification; an undertaking by the applicant to notify promptly the Commission in writing if any information submitted in support of the application becomes materially false or misleading while the application is pending; a copy of the questionnaire or application for employment specified in Rule 15Fb6–2(b),<sup>123</sup> with respect to the associated person; in cases where the associated person has been subject of any proceedings resulting in the imposition of disciplinary sanctions during the five years preceding the filing of the application or is the subject of a pending proceeding by the Commission, CFTC, any federal or state regulatory or law enforcement agency, registered futures association, foreign

financial regulatory authority, registered national securities association, or any other SRO, or commodities exchange or any court, a copy of the related order, decision, or document issued by the court, agency or SRO.

- A written statement that includes the information specified in proposed paragraphs (d) and (g) to Rule of Practice 194, including, but not limited to: The associated person’s compliance with any order resulting in statutory disqualification; the capacity or position in which the person subject to a statutory disqualification proposes to be associated with the SBS Entity; the terms and conditions of employment and supervision to be exercised over such associated person and, where applicable, by such associated person; the compliance and disciplinary history, during the five years preceding the filing of the application, of the SBS Entity; information concerning prior applications or processes.

To make an application under proposed Rule of Practice 194, the SBS Entity filing an application with respect to an associated person that is not a natural person would provide to the Commission:

- Exhibits required by proposed paragraph (e) to Rule of Practice 194, including a copy of the order or other applicable document that resulted in the associated person being subject to a statutory disqualification; an undertaking by the applicant to notify promptly the Commission in writing if any information submitted in support of the application becomes materially false or misleading while the application is pending; organizational charts of the associated person (if available); certain applicable policies and procedures of the associated person; a copy of an order, decision, or document issued by the court, agency or SRO issued during the five years preceding the filing of the application; in cases where the associated person has been subject of any proceedings resulting in the imposition of disciplinary sanctions during the five years preceding the filing of the application or is the subject of a pending proceeding by the Commission, CFTC, any federal or state regulatory or law enforcement agency, registered futures association, foreign financial regulatory authority, registered national securities association, or any other SRO, or commodities exchange or any court, a copy of the related order, decision, or document issued by the court, agency or SRO; the names of any natural persons employed by the associated person that are subject to a statutory disqualification and that would effect or be involved in effecting

security-based swaps on behalf of the SBS Entity.

- A written statement that includes the information specified in proposed paragraphs (f) and (g) to Rule of Practice 194, including, but not limited to: General background information about the associated person; the associated person’s compliance with any order resulting in statutory disqualification; the capacity or position in which the person subject to a statutory disqualification proposes to be associated with the SBS Entity; the compliance and disciplinary history, during the five years preceding the filing of the application, of the SBS Entity; information concerning prior applications or processes.

- To be eligible for the temporary exclusion set forth in paragraph (i)(1)(ii) and (i)(1)(iii) to proposed Rule of Practice 194, under proposed paragraph (i)(2), the SBS Entity would be required to file with the application a notice setting forth the name of the SBS Entity and the name of the associated person that is subject to a statutory disqualification, and attaching as an exhibit to the notice a copy of the order or other applicable document that resulted in the associated person being subject to a statutory disqualification.

Under paragraph (h) to proposed Rule of Practice 194, an applicant could submit a written statement in response to any adverse recommendation proposed by Commission staff with respect to an application under proposed Rule of Practice 194.

An SBS Entity would not be required to file an application under proposed Rule of Practice 194 with respect to certain associated persons that are subject to a statutory disqualification, as provided for in proposed paragraph (j) of proposed Rule of Practice 194. To meet those requirements, however, the SBS Entity would be required to file a notice with the Commission. For associated persons that are natural persons, the notice in proposed paragraph (j)(2)(iii) would set forth: (1) The name of the SBS Entity; (2) the name of the associated person subject to a statutory disqualification; (3) the name of the associated person’s prospective supervisor(s) at the SBS Entity; (4) the place of employment for the associated person subject to a statutory disqualification; and (5) identification of any SRO or agency that has indicated its agreement with the terms and conditions of the proposed association, registration or listing as a principal. For associated persons that are not natural persons, the notice in proposed paragraph (j)(2)(iv) would set forth: (1) The name of the SBS Entity; (2) the

<sup>123</sup> 17 CFR 240.15Fb6–2(b).

name of the person associated that is subject to a statutory disqualification and that will effect or be involved in effecting security-based swaps on behalf of the SBS Entity; and (3) identification of any SRO or agency that has indicated its agreement with the terms and conditions of the proposed association, registration or listing as a principal.

The information sought in connection with proposed Rule of Practice 194 would assist the Commission in determining whether allowing associated persons to effect or be involved in effecting security-based swaps on behalf of a SBS Entity, notwithstanding statutory disqualification, is consistent with the public interest.

The Commission has sought to minimize the burdens and costs associated with proposed Rule of Practice 194. First, the Commission is not requiring an application under proposed Rule of Practice 194 with respect to certain associated persons subject to a statutory disqualification previously granted relief (*i.e.*, by Commission, CFTC, SRO, or NFA). Rather, in such instances, SBS Entities would only be required to provide a brief notice to the Commission under proposed Rule of Practice 194(j)(2)(iii) (with respect to associated persons that are natural persons) and (j)(2)(iv) (with respect to associated person entities). Second, proposed Rule of Practice 194 generally requires information that is already required by Rule of Practice 193<sup>124</sup> and FINRA Forms MC400<sup>125</sup> and MC-400A.<sup>126</sup> Because the requirements in proposed Rule of Practice 194 would generally be similar to pre-existing requirements in Rule of Practice 193 and FINRA Forms MC-400 and MC-400A (and largely use the same terminology), proposed Rule of Practice 194 should provide a familiar process for respondents.<sup>127</sup> Third, where appropriate, the Commission has limited the scope of certain requirements, including by limiting the time period (for example, paragraphs (c)(4), (d)(6), (d)(10), (e)(5), (f)(6), and (f)(7) to proposed Rule of Practice 194) or the scope of information sought (for example, paragraph (d)(10) and (f)(7) to proposed Rule of Practice 194). Finally, the documents that are requested to be provided with the written statement in paragraphs (c) and (e) of proposed Rule of Practice 194 (*e.g.*, a copy of the order

or other applicable document that resulted in statutory disqualification) should be readily available or accessible to the SBS Entity or to the associated person.

#### B. Proposed Use of Information

Information collected in connection with an application under proposed Rule of Practice 194 would assist the Commission in determining whether an associated person of an SBS Entity should be permitted to effect or be involved in effecting security-based swaps on behalf of the SBS Entity, notwithstanding that the associated person is subject to a statutory disqualification. Although, absent the proposed rule, an SBS Entity could nonetheless submit an application for an exemptive order directly under Exchange Act Section 15F(b)(6),<sup>128</sup> proposed Rule of Practice 194 would specify the information the Commission needs to evaluate such an application, and under what standard the Commission will consider whether to grant such relief.

Information collected in connection with the notices provided by Rule of Practice 194(j)(2)(iii) and (j)(2)(iv) would assist the Commission for examination purposes by identifying associated persons that are subject to a statutory disqualification (and other basic information).

#### C. Respondents

The Commission has previously stated that it believes that, based on data obtained from the Depository Trust & Clearing Corporation and conversations with market participants, approximately fifty entities may fit within the definition of security-based swap dealer and up to five entities may fit within the definition of major security-based swap participant—55 SBS Entities in total.<sup>129</sup>

With respect to associated persons that are natural persons, as discussed in Section V.C.1 below, the Commission has estimated that there will be 423 total associated persons that are natural persons at each SBS dealer and 63 total associated persons that are natural persons at each major participant, or 21,465 total associated persons that are natural persons.<sup>130</sup> The Commission

anticipates that, on an average annual basis, only a small fraction of the natural persons would be subject to a statutory disqualification. By way of comparison, of the nearly 4,000 currently registered broker-dealers and approximately 272,000 registered representatives,<sup>131</sup> for 2014, FINRA received 24 MC-400 applications with respect to individuals subject to a statutory disqualification seeking relief under the FINRA Rule 9520 Series.<sup>132</sup> Given that the Commission estimates that there will be far fewer SBS Entities (55) and associated persons of SBS Entities that are natural persons (21,465 total associated persons that are natural persons), the Commission anticipates that SBS Entities will file for relief under Rule of Practice 194 with respect to substantially fewer associated persons that are natural persons.

In addition, to estimate the number of such persons, the Commission staff has conferred with NFA to assess how many associated persons of the 112 provisionally registered Swap Entities<sup>133</sup> have applied for relief from CEA 4s(b)(6)<sup>134</sup> (the analogous provision to Exchange Act Section 15F(b)(6)<sup>135</sup> for SBS Entities) for determination by NFA that, had the associated person applied for registration as an associated person of a Swap Entity, notwithstanding statutory disqualification, the application would have been granted.<sup>136</sup> NFA has informed Commission staff that, from October 2012 to July 22, 2015, NFA determined that in 9 out of 11 requests NFA would have granted registration with respect to the associated person subject to a statutory disqualification.

Accordingly, based on that available data, the Commission estimates that, on an average annual basis, SBS Entities would seek relief in accordance with proposed Rule of Practice 194 for five

SIFMA Letter, at 8. However, the commenter did not provide supporting data. The Commission nonetheless has revised its estimate of the number of associated persons. See Registration Adopting Release, at Section IV.D.4.

<sup>131</sup> Based on an analysis of regulatory filings, as of December 31, 2014, there are 3,954 broker-dealers that employed full-time registered representatives and were doing a public business; these broker-dealers each employed on average 69 registered representatives, or approximately 272,000 in total. See Note 158, *infra*.

<sup>132</sup> See Section V.C.2, *infra*.

<sup>133</sup> See NFA SD/MSP Registry, <https://www.nfa.futures.org/NFA-swaps-information/regulatory-info-sd-and-msp/SD-MSP-registry.HTML>.

<sup>134</sup> 7 U.S.C. 6s(b)(6).

<sup>135</sup> 15 U.S.C. 78o-10(b)(6); see Section II.B.3, *supra*.

<sup>136</sup> See EasyFile AP Statutory Disqualification Form Submission, NFA, <https://www.nfa.futures.org/NFA-electronic-filings/easyFile-statutory-disqualification.HTML>, *supra* Note 50.

<sup>124</sup> 17 CFR 201.193.

<sup>125</sup> See FINRA Form MC-400, Note 33, *supra*.

<sup>126</sup> See FINRA Form MC-400A, Note 34, *supra*.

<sup>127</sup> The Commission has estimated that approximately 16 registered SBS Entities will be broker-dealers, and thus registered with FINRA. See Registration Adopting Release, at Section IV.C.

<sup>128</sup> 15 U.S.C. 78o-10(b)(6).

<sup>129</sup> See Application of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities, Exchange Act Release No. 72472 (June 25, 2014), 79 FR 47278, 47300 (Aug. 12, 2014) ("Cross-Border Adopting Release").

<sup>130</sup> One commenter questioned the Commission's estimate, stating that some entities "could have hundreds, if not thousands, of associated natural persons that will effect or will be involved in effecting security-based swaps." See 12/16/11

natural persons subject to a statutory disqualification, and SBS Entities would provide notices pursuant to proposed Rule of Practice 194(j)(2)(iii) for five natural persons.

With respect to associated persons that are not natural persons, as discussed in Section V.C.1 below, the Commission has estimated that as many as 868 entity persons may be associating with all SBS Entities.<sup>137</sup> In the Registration Adopting Release, the Commission adopted Exchange Act Rule 15Fb6-1,<sup>138</sup> which provides that, unless otherwise ordered by the Commission, an SBS Entity, when it files an application to register with the Commission as a security-based swap dealer or major security-based swap participant, may permit an associated person associated that is not a natural person and that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, provided that the statutory disqualification(s) under Exchange Act Section 3(a)(39)(A) through (F)<sup>139</sup> occurred prior to the compliance date set forth in the Registration Adopting Release, and provided that it identifies each such associated person in the registration application. Therefore, such SBS Entities will not file an application or notice under proposed Rule of Practice 194 where Exchange Act Rule 15Fb6-1<sup>140</sup> is applicable.

The Commission preliminarily believes that Exchange Act Rule 15Fb6-1 will apply to the bulk of statutorily disqualified associated persons that are not natural persons, and that, on an average annual basis, a limited number of the associated persons that are not natural persons would be subject to a statutory disqualification. By way of comparison, in 2014, of the nearly 4,000 registered broker-dealers, FINRA received 10 MC-400A applications with respect to member firms (nine of which were related to the entity, while one was due to an owner/control person of the member firm being subject to a statutory disqualification),<sup>141</sup> and the total number of MC-400A applications received during that five year period (from 2010-2014) was 63.<sup>142</sup> Because

there would be far fewer SBS Entities, the Commission preliminarily estimates that, on an average annual basis, SBS Entities would seek relief in accordance with proposed Rule of Practice 194 for two associated persons that are not natural persons and that are subject to a statutory disqualification, and SBS Entities would provide notices pursuant to proposed Rule of Practice 194(j)(2)(iv) for two associated persons that are not natural persons.

Therefore, the Commission anticipates that, on an average annual basis, SBS Entities would file five applications under proposed Rule of Practice 194 with respect to associated persons that are natural persons, two applications under proposed Rule of Practice 194 with respect to associated persons that are entities, and seven notices for natural persons and entities under proposed Rule of Practice 194(j)(2)(iii) and (j)(2)(iv). The Commission seeks comment on these estimates.

#### *D. Total Burden Estimates Relating to Proposed Rule of Practice 194*

It is likely that the time necessary to complete an application under proposed Rule of Practice 194 would vary depending on the number of exhibits required to be submitted in accordance with proposed Rule of Practice 194(c) and (e), and the amount of information that would need to be discussed in the written statement, as specified in proposed Rule of Practice 194(d), (f) and (g).

Based on the Commission staff's estimates and experience,<sup>143</sup> the Commission estimates that the average time necessary for an SBS Entity to research the questions, and complete and file an application under Rule of Practice 194 (including any response under proposed Rule of Practice 194(h)), as well as the notice provided for in proposed paragraph (i)(2), if applicable, with respect to an associated person that is an entity would be approximately one

disqualification if that person has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person described by paragraphs (A), (B), (C), or (D) of Exchange Act Section 3(a)(39). For purposes of identifying whether a member of an SRO is subject to a statutory disqualification under Exchange Act Section 3(a)(39), an associated person may include persons that are not natural persons. See FINRA Regulatory Notice 09-19, at 3.

<sup>143</sup> For example, based on the experience relative to Form BD, the Commission has estimated the average time necessary for an SBS Entity to research the questions and complete and file a Form SBSE, including the accompanying schedules and disclosure reporting pages—which solicit information regarding statutory disqualification—to be approximately one work week, or 40 hours. See Registration Adopting Release, at Section IV.D.1.

work week, or 40 hours. The Commission believes that, for applications with respect to associated persons that are natural persons, the information requested under proposed Rule of Practice 194 is on average less than for entities, and that the written statement and supporting papers would require less time to complete. The Commission therefore estimates that for associated persons that are natural persons it would take SBS Entities approximately 75% of the time that it would take to research the questions, and complete and file an application under Rule of Practice 194 for associated persons that are entities, or 30 hours. In addition, the Commission believes that the average time necessary for an SBS Entity to research the questions, complete and file the brief notice under proposed Rule of Practice 194(j)(2)(iii) or 194(j)(2)(iv) would be less than for a full application under proposed Rule of Practice 194 and the Commission estimates that it would take approximately 3 hours.

Given that the Commission estimates that, on an average annual basis, there will be five applications under proposed Rule of Practice 194 with respect to associated persons that are natural persons, two applications under proposed Rule of Practice 194 with respect to associated persons that are entities, and seven notices under proposed Rule of Practice 194(j)(2)(iii) and (j)(2)(iv), the Commission estimates the total burden associated with filing such applications and notices on average to be 251 hours on an annual basis.<sup>144</sup> The Commission seeks comment on these estimates.

The Commission seeks comment on the collection of information burdens associated with proposed Rule of Practice 194.

Q-50. Is the estimate for the number of applications under Rule of Practice 194 appropriate? Is the estimate for the number of notices under proposed Rule of Practice 194(j)(2)(iii) and (j)(2)(iv) appropriate?

Q-51. Is the estimate for the amount of time that it would take on average for an SBS Entity to complete an application (and, if applicable, the accompanying notice provided for in proposed paragraph (i)(2)) under Rule of Practice 194 appropriate? Is the estimate for the amount of time that it would take

<sup>144</sup> This estimate is based on the following: [(40 hours) × (2 SBS Entities applying with respect to associated persons that are entities) + (30 hours) × (5 SBS Entities applying with respect to associated persons that are natural persons) + (3 hours) × (7 SBS Entities filing notices under proposed Rule of Practice 194(j)(2)(iii) and (j)(2)(iv))] = 251 hours total.

<sup>137</sup> See Note 159, *infra*.

<sup>138</sup> 17 CFR 240.15Fb6-1.

<sup>139</sup> 15 U.S.C. 78c(a)(39)(A)-(F).

<sup>140</sup> 17 CFR 240.15Fb6-1.

<sup>141</sup> See Section V.C.2, *infra*.

<sup>142</sup> We note that under FINRA rules, only the FINRA member itself (*i.e.*, the broker-dealer entity) would apply under Form MC-400A, not associated persons that are entities. Therefore, these estimates may more closely represent the number of affected broker-dealers, rather than the number of statutorily disqualified entities seeking to associate. However, under Exchange Act Section 3(a)(39)(E), 15 U.S.C. 78c(a)(39)(E), a person may be subject to a statutory

on average for an SBS Entity to complete a notice under proposed Rule of Practice 194(j)(2)(iii) and (j)(2)(iv) appropriate?

Q–52. Would SBS Entities incur costs for outside counsel in preparing applications under proposed Rule of Practice 194? If so, please provide estimates and any supporting data, if available.

#### E. Confidentiality

The information collected pursuant to proposed Rule of Practice 194 will be kept confidential, subject to the provisions of applicable law.

#### F. Request for Comment

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection is necessary for the proper performance of our functions, including whether the information shall have practical utility;

2. Evaluate the accuracy of our 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. Evaluate whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090, with referenced to File No. S7–14–15. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File No. S7–14–15, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE., Washington, DC 20549. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

## V. Economic Analysis

### A. Introduction

Exchange Act Section 15F(b)(6)<sup>145</sup> prohibits an SBS Entity from permitting an associated person who is subject to a statutory disqualification from effecting or being involved in effecting security-based swaps on behalf of the SBS Entity if the SBS Entity knew, or in the exercise of reasonable care should have known, of the statutory disqualification. Exchange Act Section 15(b)(6) also authorizes the Commission to provide relief from the statutory prohibition by rule, regulation, or order.

Exchange Act Section 15F(b)(6) imposes a general prohibition on statutorily disqualified associated persons from effecting or being involved in effecting security-based swaps on behalf of an SBS Entity unless otherwise permitted by the Commission. Concurrently with this proposal, the Commission is adopting final rules and forms establishing the registration process for SBS Entities. Among other things, these rules reference the events in the existing definition of statutory disqualification in Exchange Act Section 3(a)(39)(A) through (F)<sup>146</sup> and apply them to Exchange Act Section 15F(b)(6). This definition disqualifies associated persons from effecting or being involved in effecting security-based swaps due to violations of the securities laws, but also for all felonies and certain misdemeanors, including felonies and misdemeanors not related to the securities laws and/or financial markets. Under Exchange Act Section 15F(b)(6), absent Commission action, SBS Entities will be unable to utilize any associated person, including associated entities and natural persons with potentially valuable capabilities, skills or expertise, to effect or be involved in effecting security-based swaps if they have been disqualified for any reason, including non-investment-related conduct that may not pose a risk to security-based swap market participants.<sup>147</sup>

Under the final registration rules, the statutory prohibition in Exchange Act Section 15F(b)(6) applies to all associated persons, including both natural persons and associated entities of SBS Entities. The Commission is

<sup>145</sup> 15 U.S.C. 78o–10(b)(6).

<sup>146</sup> 15 U.S.C. 78c(a)(39)(A)–(F). See Note 16, *supra*.

<sup>147</sup> Final registration rules also require the Chief Compliance Officer of an SBS Entity, or his or her designee, to certify on its registration form that none of its associated persons that effect or are involved in effecting security-based swaps on its behalf are subject to a statutory disqualification. See Registration Adopting Release, at Section II.B.3.

proposing Rule of Practice 194 to provide a process for a registered SBS Entity to make an application to the Commission to issue an order permitting an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity. Among other things, the proposed rule would:

- Specify how SBS Entities may apply to the Commission to permit an associated person subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of an SBS Entity, including the form of application, items to be addressed, and standard of review and requiring applicants to make a showing that permitting the associated person to effect or be involved in effecting security-based swaps is consistent with the public interest;

- Provide a temporary exclusion from the general statutory prohibition pending a Commission, CFTC, SRO or registered futures association decision on an application regarding associated person entities effecting or involved in effecting security-based swaps on behalf of SBS Entities, if the application is filed within 30 days of the disqualification event or of the beginning of an association with a previously disqualified entity and a notice has been filed with the Commission within the same 30-day time period. The temporary exclusion expires 180 days following the filing of a complete application with, or initiation of a process by, the CFTC, an SRO or a registered futures association, and in the event of an adverse decision an SBS Entity will have 60 days to conform with the general statutory prohibition. The temporary exclusion pending Commission decision expires 180 days from the date of filing a complete application if the Commission has not rendered a decision on the application, after which SBS Entities will have 60 days to conform with the general statutory prohibition;

- Allow SBS Entities, under certain conditions, to permit associated persons who are subject to a statutory disqualification to effect or be involved in effecting security-based swaps on their behalf, provided the Commission, the CFTC, an SRO or a registered futures association has granted a prior application or otherwise granted relief after a statutory disqualification review of that associated person, and provided appropriate notice has been filed.

Proposed Rule of Practice 194 is intended to establish a framework for SBS Entities seeking relief from the statutory prohibition in Exchange Act

Section 15F(b)(6). Exchange Act Section 15F(b)(6) gives the Commission flexibility to address statutory disqualification situations, including by order. Under this section, the prohibition with respect to statutorily disqualified persons applies “[e]xcept to the extent otherwise specifically provided by rule, regulation, or order of the Commission.”<sup>148</sup> This statutory provision gives the Commission discretion to determine that a statutorily disqualified person may effect or be involved in effecting security-based swaps on behalf of an SBS Entity. Exchange Act Section 15F(b)(6), however, does not specify what information should be provided to the Commission when an SBS Entity seeks relief, nor does it set forth the standard under which the Commission would evaluate requests for relief. Proposed Rule of Practice 194 specifies the information and documents that SBS Entities should provide to the Commission, as well as the applicable procedures and standard of review, for seeking relief from the statutory prohibition in Exchange Act Section 15F(b)(6). While the Exchange Act provides the Commission with the authority to make a determination with respect to a statutorily disqualified person, the structured process outlined in proposed Rule of Practice 194 is designed to ensure that the Commission has sufficient information to evaluate whether providing relief for an associated person under Exchange Act Section 15F(b)(6) is consistent with the public interest.

#### *B. General Economic Considerations*

In considering proposed Rule of Practice 194 and alternative regulatory approaches to a process for addressing statutory disqualification, we are mindful of the costs imposed by and the benefits obtained from our rules. Section 3(f) of the Exchange Act<sup>149</sup> provides that whenever the Commission is engaged 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, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act<sup>150</sup> requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition. Exchange Act Section

23(a)(2) also provides that the Commission shall not adopt any rule which would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The discussion below addresses the potential economic effects of the proposed Rule of Practice 194, including the likely benefits and costs of the rules and their potential impact on efficiency, competition, and capital formation.

As we have noted, Exchange Act Section 15F(b)(6) gives the Commission authority to provide relief from the statutory prohibition against associating with disqualified persons by rule, regulation, or order, and the Commission is not bound by any particular approach in exercising its discretion to provide relief. In particular, in the absence of the proposed rule or any other proposed approach, SBS Entities would still be able to apply for relief from Exchange Act Section 15F(b)(6) and the Commission would be able to issue an order either granting or denying relief. When determining whether to make an application for relief with respect to an associated person, an SBS Entity will weigh the scarcity and value of the particular skills of an associated person that is a natural person or the profits generated by an associated person entity’s security-based swap business against (1) the application costs and reputational costs that come with choosing to associate with disqualified persons, and (2) their beliefs as to the likelihood of an approval or denial decision by the Commission. To the extent that proposed Rule of Practice 194 alters an SBS Entity’s assessment of either application and reputational costs or beliefs about likely outcomes and the decision to apply with the Commission, economic costs and benefits may accrue to SBS Entities, associated persons, and counterparties to SBS Entities.

The Commission preliminarily believes that the primary benefits of the proposed approach are in (1) providing SBS Entities clarity regarding the items to be addressed, the information and supporting documentation to be submitted, and the standard of review (affecting application costs and beliefs about likely outcomes), and (2) ensuring that the Commission has sufficient information to make a meaningful determination that allowing an SBS Entity to permit statutorily disqualified associated persons to effect security-based swaps is consistent with the public interest. Finally, we note that regardless of the regulatory approach chosen, SBS Entities may find it less

costly to disassociate with, or reassign, disqualified persons than to apply for relief.

The Commission lacks data on the complexity and variety of current SBS Entity business structures and activities, the degree of SBS Entity business reliance on associated persons subject to a statutory disqualification, the location and specificity of expertise of such persons, as well as the reputational costs of associating with disqualified persons. Further, the economic effects of various provisions of proposed Rule of Practice 194 hinge on whether and how significantly SBS Entities may be affected by the statutory prohibition in Exchange Act Section 15F(b)(6); how market participants will react to SBS Entities seeking relief through a Commission order compared to relief under proposed Rule of Practice 194, which will affect the reputational costs of the application under Rule of Practice 194 relative to baseline; and how other SBS Entities will react to the newly opened market share should some SBS Entities temporarily cease effecting security-based swaps or exit due to the statutory prohibition in Exchange Act Section 15F(b)(6). To the best of our knowledge, no such data are publicly available. We, therefore, cannot quantify many of the effects, including the tradeoff behind an SBS Entity’s choice to pursue relief and face potential reputational losses versus disassociating with the statutorily disqualified associated person. Where we cannot quantify, we discuss in qualitative terms the relevant economic effects, including the costs and benefits of proposed Rule of Practice 194 and alternative approaches.

#### *C. Economic Baseline*

To assess the economic impact of proposed Rule of Practice 194, the Commission is using as a baseline the regulation of SBS Entities as it exists at the time of this proposal, including applicable rules we have adopted, but excluding rules that we have proposed but not yet finalized. Included in our baseline are final rules establishing registration requirements for SBS Entities, which are being adopted concurrently with this proposal.<sup>151</sup>

Our economic baseline presumes that the general prohibition in Exchange Act Section 15F(b)(6)<sup>152</sup> is in effect, and compliance with registration requirements is required. However, we note that prior to adoption of final registration rules, the Commission previously provided temporary relief

<sup>148</sup> 15 U.S.C. 78o–10(b)(6).

<sup>149</sup> 15 U.S.C. 78c(f).

<sup>150</sup> 15 U.S.C. 78w(a)(2).

<sup>151</sup> See Registration Adopting Release.

<sup>152</sup> 15 U.S.C. 78o–10(b)(6).

from Exchange Act Section 15F(b)(6) for certain associated persons. Specifically, on June 15, 2011, the Commission issued an order granting temporary relief from Exchange Act Section 15F(b)(6) for persons subject to a statutory disqualification who were associated with an SBS Entity as of July 16, 2011.<sup>153</sup> As discussed in the Registration Adopting Release, SBS Entities are required to comply with the statutory prohibition set forth in Exchange Act Section 15F(b)(6).<sup>154</sup> However, under Exchange Act Rule 15Fb6-1,<sup>155</sup> unless otherwise ordered by the Commission, an SBS Entity, when it files an application to register with the Commission as a security-based swap dealer or major security-based swap participant, may permit statutorily disqualified associated person entities to effect or be involved in effecting security-based swaps on its behalf, provided that the statutory disqualification occurred prior to the compliance date set forth in the Registration Adopting Release, and provided that the SBS Entity identifies each such associated person on Schedule C of the applicable registration form. Additionally, we note that the compliance date of final registration rules will not occur until, among other things, the Commission adopts final rules establishing a process for a registered SBS Entity to apply for relief from the statutory disqualification provision in Exchange Act Section 15F(b)(6).<sup>156</sup>

Thus, there are currently no registered entities that are required to comply with either the statutory disqualification certifications in the final registration rules or the statutory prohibition in Exchange Act Section 15F(b)(6). Nevertheless, the Commission believes that in order to perform a meaningful assessment of proposed Rule of Practice 194, the appropriate baseline is one where compliance with final

registration rules is required, the general statutory prohibition is in effect, and the Commission may use its authority under Exchange Act Section 15F(b)(6) to issue an order providing relief.

#### 1. Affected Participants

Because final registration rules are being adopted concurrently with this proposal, but compliance is not yet required, we do not have data on the actual number of SBS Entities that will register with the Commission, or the number of persons associated with registered SBS Entities. However, in the Registration Adopting Release, the Commission estimated that up to 50 entities may register with the Commission as security-based swap dealers, and up to five additional entities may register as major security-based swap participants.<sup>157</sup> Furthermore, we estimate that as many as 423 natural persons may associate with each dealer and as many as 63 natural persons may associate with each major participant, or 21,465 in total.<sup>158</sup> In addition, we estimate that 868 entity persons may be associating with all SBS Entities.<sup>159</sup> We note that SBS Entities

<sup>157</sup> See Registration Adopting Release, at Section IV.C; Section V.B, *supra*.

<sup>158</sup> Based on an analysis of broker-dealer FOCUS reports, as of December 31, 2014, there were 3,954 broker-dealers that employed full-time registered representatives and were doing a public business; these broker-dealers each employed on average 69 registered representatives, or approximately 272,000 in total. However, based on our review of the 50 entities we believe may register as security-based swap dealers, the Commission believes the subset of clearing broker-dealers provides a better estimate. As of December 31, 2014, there were 447 clearing broker-dealers which had, on average, each employed 423 persons who were registered representatives; we use this average as the basis for our estimate of 21,150 natural persons associated with dealers. Note, however, that SBS Entities will be limited to sales of security-based swaps, whereas broker-dealers are generally engaged in the sale of a broader range of financial instruments, as well as other business lines such as prime brokerage services. Thus, it is possible that fewer people would be needed to facilitate this business.

Since registration requirements for major security-based swap participants are triggered by position thresholds, as opposed to activity thresholds for dealer registration, we anticipate that entities which may seek to register with the Commission as major security-based swap participants may more closely resemble hedge funds and investment advisors. To estimate the number of natural persons associated with major security-based swap participants, we use Form ADV filings by registered investment advisers. Based on this analysis, as of January 2, 2015 there were 11,506 registered investment advisers; these investment advisers had an average 63 employees each. We use this average as the basis for our estimate of 315 natural persons associated with major security-based swap participants.

<sup>159</sup> Based on an analysis of historical Form BD filings, broker-dealers with control affiliates had an average of 6.84 control affiliates that started to associate between 2000 and 2014, and have not ended the association by December 31, 2014. We preliminarily believe that it may be appropriate to

currently intermediating security-based swaps are frequently part of complex organizational structures, which may include thousands of natural persons and hundreds of entities. Further, we preliminarily believe that SBS Entities may adjust their organizational structures and activities in response to the associated person and other requirements of final registration rules and the pending substantive Title VII rules. We also preliminarily anticipate that there may be a high degree of heterogeneity in business structures and organizational complexity among SBS Entities. The Commission lacks data on SBS Entity associations with disqualified entities effecting or involved in effecting security-based swaps on their behalf. It is, therefore, difficult to estimate with a high degree of certainty the number of associated persons and associated persons currently intermediating security-based swaps on behalf of SBS Entities that may be affected by the proposed rules.

#### 2. Incidence of Disqualification

While the Commission lacks data on the incidence of statutory disqualifications in the security-based swap market, we look to the securities market and the experience of broker-dealers as a guide.<sup>160</sup> Based on

scale the figure by a factor of two to account for complexity in business structures and for the fact that security-based swap dealers are likely to resemble some of the larger broker dealers, which results in an estimate of up to 684 ( $6.84 * 50 * 2 = 684$ ) entities associated with security-based swap dealers. As discussed in our estimates of associated natural persons, SBS Entities will be limited to sales of security-based swaps, whereas broker-dealers are generally engaged in the sale of a broader range of financial instruments, and it is possible that fewer entities would be needed to facilitate this business.

Using historical Form ADV filings for investment advisers with control persons as of March 2015, investment advisers with control persons had an average of approximately 18.35 control persons listed as firms or organizations that started to associate between 2000 and 2014, and have not ended the association by December 31, 2014. We preliminarily believe that it may be appropriate to scale the figure by a factor of two to account for complexity in business structures and for the fact that major swap participants are likely to be similar to some of the larger investment advisers, which results in an estimate of up to approximately 184 ( $18.35 * 5 * 2 = 183.5$ ) entities associated with major security-based swap market participants.

<sup>160</sup> We have also requested data from NFA. According to NFA staff, between October 11, 2012 and July 22, 2015, 11 applications had been made by Swap Entities to NFA for NFA to provide notice to the Swap Entity that, had the person applied for registration as an associated person, NFA would have granted such registration. See CFTC Staff No-Action Letter, *supra* Note 49, at 5-8. The Commission has estimated that up to 55 SBS Entities may seek registration, while the CFTC has provisionally registered 112 Swap Entities (<https://www.nfa.futures.org/NFA-swaps-information/regulatory-info-sd-and-msp/SD-MSP-registry.HTML>; last accessed July 24, 2015). Using

<sup>153</sup> See Note 13, *supra*.

<sup>154</sup> 15 U.S.C. 78o-10(b)(6); see Registration Adopting Release, at Section II.B.1.i. The compliance date set forth in the Registration Adopting Release is the later of: Six months after the date of publication in the **Federal Register** of a final rule release adopting rules establishing capital, margin and segregation requirements for SBS Entities; the compliance date of final rules establishing recordkeeping and reporting requirements for SBS Entities; the compliance date of final rules establishing business conduct requirements under Exchange Act Sections 15F(h) and 15F(k); or the compliance date for final rules establishing a process for a registered SBS Entity to make an application to the Commission to allow an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on the SBS Entity's behalf. See Registration Adopting Release, at 1.

<sup>155</sup> 17 CFR 240.15Fb6-1.

<sup>156</sup> See Note 154, *supra*.

information provided by FINRA to the Commission, in 2014 FINRA received 24 MC-400 applications for individuals subject to a statutory disqualification seeking relief under the FINRA Rule 9520 Series. Of these applications, 13 were for investment-related disqualification, 10 were non-investment-related, and one was for both investment and non-investment disqualifications. Further, in 2014, FINRA received an additional 10 MC-400A applications for statutorily disqualified member firms under Rule 9520 Series. Of the MC-400A applications received by FINRA, nine were related to the entity, while one was due to an owner/control person of the member firm being disqualified (all with investment-related trigger events).

The Commission preliminarily believes that the incidence of statutory disqualification among broker-dealers serves as a reasonable basis to estimate the incidence of disqualification among SBS Entities, because both broker-dealers and SBS Entities are engaged in the business of intermediating trade in financial instruments. As described above, in 2014 FINRA received 24 applications for individuals and 10 applications for member firms, out of approximately 272,000 registered representatives and 4,000 currently registered broker-dealers. We estimate that 55 entities will register with the Commission as SBS Entities, with an estimated 21,465 associated natural persons and 868 associated person entities. Assuming the number of applications for association with statutorily disqualified persons at SBS Entities is the same as at broker-dealers results in an estimate of approximately two applications for natural persons and one application for entities per year.<sup>161</sup> Recognizing that this is an estimate, we preliminarily believe it is reasonable to estimate that the Commission will receive up to five applications per year with respect to natural persons and up

the above data from NFA concerning 11 applications over approximately 2.78 years, results in an estimate of approximately 2 applications per year ( $11 * 55/112/2.78 \approx 1.94$ ).

The Commission, however, recognizes that the number of applications received by NFA may only present a partial picture of the potential impact of a disqualification because, *inter alia*, (1) the CFTC defines "associated person" of a Swap Entity to be limited solely to natural persons, not entities (*see* 17 CFR 1.3(aa)(6)); (2) in CFTC Regulation 23.22(b), 17 CFR 23.22(b), the CFTC provided an exception from the prohibition set forth in CEA Section 4s(b)(6), 7 U.S.C. 6s(b)(6), for any person subject to a statutory disqualification who is already listed as a principal, registered as an associated person of another CFTC registrant, or registered as a floor broker or floor trader.

<sup>161</sup> For natural persons:  $21,465 * (24/272,000) = 1.89$ . For entities:  $868 * (10/4000) = 2.18$ .

to two applications per year with respect to entities.<sup>162</sup>

### 3. Existing Regulatory Frameworks

As reflected in Section II.B, the Commission, CFTC, FINRA, and NFA have already established processes that enable various persons subject to a statutory disqualification or other bars to be permitted to associate with regulated entities transacting in equity, bond, commodity, swap, and other markets. The numerous financial markets are integrated, often attracting the same market participants that trade across corporate bond, swap, and security-based swap markets, among others. The Commission has elsewhere estimated that approximately thirty-five entities currently registered with the CFTC as Swap Entities are expected to have sufficiently large security-based swap transaction volume or positions to require registration with the Commission as SBS Entities. We further estimated that sixteen market participants expected to register as SBS Entities have already registered with the Commission as broker-dealers<sup>163</sup> and, therefore, are subject to oversight by FINRA or a national securities exchange. In total, all but four entities that the Commission has estimated as potential registered SBS Entities are expected to be subject to regulatory oversight from the CFTC, FINRA, or a national securities exchange.<sup>164</sup> Therefore, we preliminarily expect SBS Entities to associate with persons effecting or involved in effecting transactions across the various markets overseen by the CFTC, FINRA and NFA.

More broadly, swaps and security-based swaps enable market participants

<sup>162</sup> Notably, paragraph (j) of proposed Rule of Practice 194 provides that an SBS Entity may permit, subject to certain circumstances, statutorily disqualified associated persons to effect or be involved in effecting security-based swaps on behalf of the SBS Entity where the Commission, CFTC, an SRO or a registered futures association has granted a prior application or otherwise granted relief from a statutory disqualification with respect to the associated person. *See* Section II.C.9, *supra*. As a result, to the extent that SBS Entities are using the same personnel to effect security-based swaps, swaps, and transact in underlying securities, the number of applications the Commission receives may be lower.

We also note that registered broker-dealers retain the option of complying with statutory disqualification provisions by disassociating with or reassigning disqualified persons. As a result, many instances of disqualification may resolve through disassociation or reassignment. Registered entities would likely take advantage of the provision only when the benefits of associating with a disqualified person outweigh the costs, including reputational costs, of making an application.

<sup>163</sup> *See* Registration Adopting Release, at Section IV.C.

<sup>164</sup> *Id.*

to trade on the risks of underlying reference securities, and these markets are integrated. As a result of cross-market participation, informational efficiency, pricing and liquidity in swaps and security-based swaps markets may influence reference security markets, and vice versa.<sup>165</sup>

### D. Benefits, Costs, and Effects on Efficiency, Competition, and Capital Formation

Exchange Act Section 15F(b)(6) provides the Commission with the authority to provide relief from the prohibition against using associated natural persons subject to a statutory disqualification to effect security-based swaps.<sup>166</sup> As discussed above, clarity provided by the proposed rule regarding the materials to be submitted, the items to be considered, and the standard of review, which may alter an SBS Entity's assessment of (1) the application costs and reputational costs that come with choosing to associate with disqualified persons, and (2) their beliefs as to the likelihood of an approval or denial decision by the Commission. To the extent that any such alteration leads to greater or fewer applications for relief under Rule of Practice 194 relative to the baseline with no process rule in place, economic costs and benefits may accrue to SBS Entities, associated persons, and counterparties to SBS Entities.

Broadly, limiting the involvement of statutorily disqualified persons in security-based swap markets on behalf of SBS Entities mitigates compliance and counterparty risks arising from disqualification and may facilitate competition among higher quality SBS Entities, better supervision and integrity of security-based swap markets. However, limits on disqualified persons may require SBS Entities to undergo business restructuring in the event of disqualification or to apply with the Commission for relief, the costs of which may be passed on to counterparties. Below we discuss this economic tradeoff as it pertains to individual rule provisions and alternatives being considered.

<sup>165</sup> *See, e.g.*, M. Massa & L. Zhang, CDS and the Liquidity Provision in the Bond Market (INSEAD Working Paper No. 2012/114/FIN, 2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2164675](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2164675); M. Oehmke & A. Zawadowski, The Anatomy of the CDS Market (Working Paper, 2014), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2023108](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2023108); S. Das, M. Kalimpalli & S. Nayak, Did CDS Trading Improve the Market for Corporate Bonds?, 111 J. Fin. Econ. 495 (2014); H. Tookes, E. Boehmer & S. Chava, Related Securities and Equity Market Quality: The Cases of CDS, forthcoming, J. Fin. & Quant. Analysis.

<sup>166</sup> 15 U.S.C. 78o-10(b)(6).

We estimate that the Commission will receive seven or fewer applications under proposed Rule of Practice 194 per year (with respect to both associated persons that are natural persons and entities), and we preliminarily believe that SBS Entities may be able to easily reassign or disassociate from disqualified natural persons for the purposes of effecting security-based swaps on behalf of SBS Entities. Therefore, we preliminarily believe the overall economic impact of the proposed rule will depend on how many associated person entities of SBS Entities become disqualified after the compliance date of final registration rules, the relative market share and structure of bilateral relationships of affected SBS Entities, and the response of other SBS Entities and market participants. We are mindful of the economic tradeoffs inherent in our policy choices and their impact on the securities markets. We discuss these economic effects in more detail below.

#### 1. Anticipated Benefits

##### a. Benefits to SBS Entities

Proposed Rule of Practice 194 establishes a structured process that provides SBS Entities clarity and guidelines on the form of application, the items to be considered, and the standard of review. Furthermore, the proposed rule ensures that the Commission will have sufficient information to make a meaningful determination that providing relief for an associated person is consistent with the public interest.

Under the baseline scenario, absent proposed Rule of Practice 194, SBS Entities would still be able to apply to the Commission, and the Commission would still be able to exercise its authority to grant relief.<sup>167</sup> Therefore, the proposed process does not affect the set of options available to either SBS Entities or the Commission, nor does it affect the range of possible outcomes. However, a key benefit of proposed Rule of Practice 194 is that, by articulating the materials to be submitted, the items to be considered, and the standard of review, it provides a structured process to SBS Entities, as well as clarity about the process.

Absent proposed Rule of Practice 194, we preliminarily believe that SBS Entities seeking to apply for relief from Section 15F(b)(6) may apply to the Commission directly, outside of a formal process, possibly looking to either Rule of Practice 193<sup>168</sup> or an

analogous process as a guide.<sup>169</sup> However, we also believe that such applications, due to the lack of clarity, would be more time-consuming, and would be more prone to errors or more likely to be deemed to contain insufficient information to allow the Commission to make a determination. Under proposed Rule of Practice 194, SBS Entities should generally be aware of the information they are required to provide, as well as the standard of review. We also believe that clarity about the items that the Commission will consider in making a determination, while not altering the set of possible outcomes, will allow SBS Entities to make more-informed assessments as to the likelihood that the Commission will either grant or deny relief. Thus, proposed Rule of Practice 194 may conserve resources and may allow SBS Entities to make more-informed evaluations about the tradeoff between pursuing an application and either disassociating with or, in the case of natural persons, reassigning a person subject to a statutory disqualification.

Finally, paragraph (j) of proposed Rule of Practice 194 provides relief in cases where the Commission, the CFTC, an SRO, or a registered futures association has granted a prior application or otherwise granted relief from a statutory disqualification with respect to that associated person. To the extent that SBS Entities, Swap Entities, and broker-dealers use the same personnel or entities to effect security-based swaps, swaps, and securities transactions, this proposed rule may conserve resources in the sense that SBS Entities will not have to undergo duplicate review when decisions about relief from statutory disqualifications have already been made by the Commission or another regulatory authority. These benefits are discussed in greater detail in Section V.D.1.c below.<sup>170</sup>

##### b. Benefits to Counterparties of SBS Entities

As stated in Section II.C.7 above, orders issued in accordance with Rule of Practice 194 would be made publicly available. Further, for SBS Entities to be able to avail themselves of the temporary exclusion set forth in proposed paragraphs (i)(1)(ii) and

<sup>169</sup> See Section II.0, *supra*.

<sup>170</sup> We note that under paragraph (j) associated persons may be permitted to effect or be involved in effecting security-based swaps on behalf of SBS Entities where the Commission would not have made an individualized positive determination in the context of such person effecting or being involved in effecting security-based swap transactions. These potential effects are discussed in Section V.D.2.b below.

(i)(1)(iii), applications related to disqualified associated entities would have to include a notice, which would be publicly disseminated by the Commission. The notice would set forth the name of the SBS Entity and the name of the associated person that is subject to a statutory disqualification, and attach as an exhibit to the notice a copy of the order or other applicable document that resulted in the associated person being subject to a statutory disqualification. Publicly available and publicly disseminated information regarding applications under proposed Rule of Practice 194 would provide market participants with information they may find useful in assessing their counterparties. In particular, market participants may use knowledge about whether an SBS Entity has applied for relief and/or whether an SBS Entity currently employs or associates with disqualified persons to effect security-based swaps when choosing counterparties. In general, such information may be valued by market participants when selecting counterparties, if they believe such knowledge is informative about the quality of a counterparty.

In addition, we note that this information may be useful to other SBS Entities. In particular, publicly available information regarding the outcome of Rule of Practice 194 applications may inform other SBS Entities' assessments of the likelihood that the Commission would grant relief in particular circumstances. For example, SBS Entities could look to outcomes in applications where disqualifications were for similar reasons; such information may be useful in determining whether it is cost effective to seek relief.

##### c. Benefits of the Commission, CFTC, SRO, Registered Futures Association Provision

Beyond establishing a process for submitting applications, proposed Rule of Practice 194 allows an SBS Entity, subject to certain conditions, to permit an associated person that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity without making an application to the Commission, if the associated person's membership, association, registration or listing as a principal has been granted or otherwise approved by the Commission, CFTC, an SRO or a registered futures association.<sup>171</sup> In such cases where an SBS Entity meets the

<sup>171</sup> See proposed Rule of Practice 194(j); see also Section II.C.9, *supra*.

<sup>167</sup> See 15 U.S.C. 78o-10(b)(6); see also Section V.C, *supra*.

<sup>168</sup> 17 CFR 201.193.

requirements of proposed paragraph (j), these SBS Entities would be able to provide notice to the Commission in lieu of having to compile the same information and documentation for a repeated review, thereby eliminating redundancy and decreasing SBS Entity costs.

The proposed rule concerning associated persons previously granted relief by the Commission, CFTC, an SRO or a registered futures association provides SBS Entities with flexibility in hiring and assigning employees, and associating with entities, depending on business needs and required capabilities. Specifically, this provision would benefit SBS Entities transacting across markets through disqualified associated persons previously granted relief by the Commission, CFTC, NFA or FINRA, by enabling them to avoid costs of a separate application process under proposed Rule of Practice 194 or business restructuring. We also recognize that this provision reduces costs to SBS Entities from associating with disqualified persons previously granted relief by the Commission, CFTC, NFA or FINRA, so it may benefit these persons by potentially improving their employment options and business outcomes.

#### d. Benefits of the Temporary Exclusion

The temporary exclusion pending decision by the Commission, the CFTC, an SRO or a registered futures association with respect to an associated person entity<sup>172</sup> prevents potentially unnecessary business restructuring or business disruption costs for SBS Entities that are affiliated with disqualified entities but have not yet received a decision on their application. Under this provision, provided that the conditions in proposed paragraph (i) are met, SBS Entities would not have to comply with the statutory prohibition in Exchange Act Section 15F(b)(6) with respect to associated person entities while an application before the Commission, the CFTC, an SRO or a registered futures association is pending. If the Commission, the CFTC, an SRO or a registered futures association does not render a decision on the application within 180 days, an SBS Entity will have 60 days to disassociate or otherwise restructure their business such that the disqualified associated person entity is not effecting or involved in effecting security-based swaps on behalf of the SBS Entity.<sup>173</sup> In

cases where the CFTC, an SRO or registered futures association makes an adverse decision on a pending application, an SBS Entity will have 60 days to conform with the general statutory prohibition, whereas for applications under Rule of Practice 194 denied by the Commission, a conformance period may be provided by order as necessary and appropriate.<sup>174</sup>

The time-limited nature of the temporary exclusion pending review<sup>175</sup> may introduce uncertainty concerning the eventual need to restructure before the Commission, the CFTC, an SRO or registered futures association has rendered a decision on the application. To the extent that the process under proposed Rule of Practice 194 provides benefits to SBS Entities and their counterparties by not requiring them to incur the costs of restructuring and complying with the statutory prohibition in Exchange Act Section 15F(b)(6) until they have received certainty on their application, the time-limited nature of the temporary exclusion pending review may reduce these benefits.

We highlight that, as discussed in the Registration Adopting Release, inter-dealer transactions account for greater than 60% of single-name CDS transactions.<sup>176</sup> The high level of inter-dealer trading activity reflects the central position of a small number of dealers, each of which may intermediate trades between many hundreds of counterparties. In the absence of a temporary exclusion pending application review, some SBS Entities may have to bear costs of restructuring or disassociating from disqualified entities. Given the small number of dealers, as well as the potential reach of dealers to hundreds of counterparties, this may increase transaction costs for counterparties should disruptions to existing bilateral relationships occur. The temporary exclusion,<sup>177</sup> as well as the 60-day conformance period<sup>178</sup> and the possibility of an extension of temporary exclusion by Commission order in cases where review applications are denied,<sup>179</sup> may mitigate these effects.

At the same time, without the temporary exclusion, other SBS Entities are likely to step in and intermediate the trades. The potential benefits of the temporary exclusion for market quality

and competition, therefore, depend on the relative importance of existing bilateral relationships and on which SBS Entities would increase their participation, if some SBS Entities are temporarily unable to intermediate swaps due to statutory disqualification absent the temporary exclusion.

It is important to note that the temporary exclusion will not apply to associated person entities with respect to which the Commission has otherwise ordered, or with respect to which the Commission, CFTC, an SRO or registered futures association has previously denied an application.<sup>180</sup> Temporarily excluding such associated person entities from the statutory prohibition in Exchange Act Section 15F(b)(6), and allowing SBS Entities to permit associated person entities to effect or be involved in effecting security-based swaps pending review may pose significant counterparty and compliance risks. However, we recognize that this aspect of the proposed rule mitigates the potential benefits described above.

We further note that the proposed temporary exclusion covers applications regarding associated person entities only, and excludes applications regarding associated persons that are natural persons. As a practical matter, an SBS Entity may be able to reassign or disassociate from a statutorily disqualified natural person effecting or involved in effecting security-based swaps, whereas disassociating from statutorily disqualified entities may require more costly restructuring.

## 2. Anticipated Costs

### a. Application Costs

Based on the Commission's experience with similar applications, the Commission preliminarily estimates that the average time necessary for an SBS Entity to research the questions, and complete and file an application under Rule of Practice 194 would be approximately 40 hours for applications regarding entities, and 30 hours for applications regarding natural persons.<sup>181</sup> Furthermore, the Commission preliminarily estimates that SBS Entities would make fewer than seven applications on an average annual basis.<sup>182</sup> Based on those figures, the Commission estimates the economic costs to prepare, review, and submit applications under proposed Rule of Practice 194 to be less than \$95,380 per

<sup>174</sup> See proposed Rule of Practice 194(i)(1)(iii).

<sup>175</sup> See proposed Rule of Practice 194(i)(1)(ii).

<sup>176</sup> See Registration Adopting Release, at Section V.C.1.ii.

<sup>177</sup> See proposed Rule of Practice 194(i)(1).

<sup>178</sup> See proposed Rule of Practice 194(i)(1)(ii), (iii).

<sup>179</sup> See proposed Rule of Practice 194(i)(3).

<sup>172</sup> See proposed Rule of Practice 194(i); see also Section II.C.8, *supra*.

<sup>173</sup> See proposed Rule of Practice 194(i)(1)(ii), (iii).

<sup>180</sup> See proposed Rule of Practice 194(i)(1).

<sup>181</sup> See Section IV.D, *supra*.

<sup>182</sup> See *id.*

year.<sup>183</sup> The Commission seeks comment on the reasonableness and accuracy of these estimates.

Notably, an SBS Entity would only submit such applications where the SBS Entity believed that the economic value of retaining a particular person to effect security-based swaps or continuing association with a statutorily disqualified entity outweighed the application costs associated with proposed Rule of Practice 194. In other words, any application costs would be incurred by SBS Entities on a voluntary basis. Furthermore, the decision to incur application costs would also reflect an SBS Entity's assessment of the likelihood of the Commission granting relief under the public interest standard set forth in proposed Rule of Practice 194(b).

We also note that, under the baseline, an SBS Entity would not be precluded under Exchange Act Section 15F(b)(6) from seeking Commission relief.<sup>184</sup> However, as already discussed, SBS Entities would lack clarity about the application process and, though they may look to Rule of Practice 193 or similar processes as a guide, could potentially expend more resources than necessary due to process uncertainty. Thus, notwithstanding the cost estimates above, the proposed rule may mitigate application costs relative to the baseline due to the structured process. We expect that this cost mitigation would be most significant for SBS Entities that would be among the first to seek relief; SBS Entities seeking relief later would have the benefit of learning by observing the process experienced by first-movers.

#### b. Costs of the Commission, CFTC, SRO, Registered Futures Association Provision

Exchange Act Rule 19h-1 provides for Commission review of notices filed by SROs proposing to admit any person to, or continue any person in, membership or association with a member, notwithstanding statutory disqualification.<sup>185</sup> The Commission does not review or approve statutory

disqualification decisions of NFA or CFTC. As a result, associated persons may be able to transact in security-based swap markets on behalf of SBS Entities where the Commission would not have made a determination on an individualized basis that it is consistent with the public interest to permit them to do so had these persons been reviewed independently by the Commission. Since this provision would result in a potentially greater number of disqualified associated persons being permitted to effect or be involved in effecting security-based swaps on behalf of SBS Entities, it may increase compliance and counterparty risks, but may decrease costs of business restructuring by affected SBS Entities, as discussed in section V.D.

#### c. Costs of the Temporary Exclusion

The temporary exclusion pending decision by the Commission, the CFTC, an SRO or a registered futures association<sup>186</sup> is designed to mitigate SBS Entity costs of reassigning or disassociating from statutorily disqualified associated person entities during the review process. However, the provision allows associated person entities to continue to effect or be involved in effecting security-based swaps on behalf of an SBS Entity after conduct that triggered statutory disqualification and before the Commission, the CFTC, an SRO or a registered futures association has made an individualized favorable determination. Statutory disqualification triggers may point to risks of repeated misconduct or compliance shortcomings, and a review by the Commission, the CFTC, an SRO or a registered futures association does not result in a determination that permitting such associations is not consistent with the public interest. In these instances, statutorily disqualified associated person entities would have been effecting or involved in effecting security-based swaps on behalf of SBS Entities, raising counterparty risks during the review process as a result of the temporary exclusion. We note that if the Commission, the CFTC, an SRO or a registered futures association does not render a decision within 180 days, the temporary exclusion expires and SBS Entities will have 60 days to conform with the general statutory prohibition.<sup>187</sup> The time-limited nature of the exclusion pending review partially mitigates the potential risks to counterparties from disqualified entities

effecting or being involved in effecting security-based swaps on behalf of SBS Entities before the Commission renders a decision on the application.

Finally, if the CFTC, an SRO or a registered futures association renders an adverse decision with respect to an entity that is an associated person an SBS Entity, SBS Entities will have 60 days to conform with the general statutory prohibition.<sup>188</sup> In cases where the Commission has made a determination that allowing an SBS Entity to permit an associated person entity that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps is not consistent with the public interest, the Commission may provide an extension to the temporary exclusion by order.<sup>189</sup> Associated person entities that are subject to a statutory disqualification would be able to effect or be involved in effecting security-based swaps on behalf of SBS Entities where the Commission, the CFTC, an SRO or NFA have made an adverse determination based on the assessment of the facts and circumstances of the application, which may pose risks to counterparties. However, these provisions provide time for SBS Entities to restructure and comply with the statutory prohibition in Exchange Act Section 15F(b)(6) after disposition of the application. Further, with respect to the temporary exclusion pending review by the Commission, in cases where an application has been disapproved, the Commission will only provide an extension to the temporary exclusion where it deems doing so is necessary or appropriate.<sup>190</sup>

#### d. Additional Costs

As we noted above, under proposed Rule of Practice 194, the Commission will make public orders either approving or denying an application under the rule.<sup>191</sup> We note that SBS Entities may prefer for such information to remain private if they believe that counterparties will use this information as a signal of quality. Therefore, the reputational costs associated with going through the process and potentially associating with statutorily disqualified persons may discourage some SBS Entities from applying for relief under the proposed rule; such SBS Entities may instead choose to disassociate with disqualified persons or reassign them (in the case of natural persons) to responsibilities that do not involve

<sup>183</sup> This estimate is based on the following. Total burden hours = ((40 hours) × (2 SBS Entities applying with respect to associated persons that are entities) + (30 hours) × (5 SBS Entities applying with respect to associated persons that are natural persons) + (3 hours) × (7 SBS Entities filing notices). Attorney at \$380 per hour × 251 burden hours = \$95,380. The hourly cost figure is based upon data from SIFMA's *Management & Professional Earnings in the Securities Industry 2013* (modified by the Commission staff to account for an 1,800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead).

<sup>184</sup> See Section V.C, *supra*.

<sup>185</sup> 17 CFR 240.19h-1.

<sup>186</sup> See proposed Rule of Practice 194(i).

<sup>187</sup> See proposed Rule of Practice 194(i)(1)(ii), (iii).

<sup>188</sup> See proposed Rule of Practice 194(i)(1)(iii).

<sup>189</sup> See proposed Rule of Practice 194(i)(3).

<sup>190</sup> See *id.*

<sup>191</sup> See Section II.C.7, *supra*.

effecting or being involved in effecting security-based swaps.

Disassociation itself may be costly, particularly for SBS Entities associated with a statutorily disqualified entity that is responsible for a large share of security-based swap business. In considering disassociation, an SBS Entity will weigh reputational costs against the cost of disassociation. For disqualified natural persons, such costs include the cost to an SBS Entity of replacing an employee (or other associated person), and will depend on the scarcity and value of a particular person's skills. For statutorily disqualified associated person entities, such costs may include the cost of eliminating or restructuring an entire business line.

### 3. Effects on Efficiency, Competition, and Capital Formation

The Commission has preliminarily assessed the effects arising from proposed Rule of Practice 194 on efficiency, competition, and capital formation. As noted above, limiting the ability of statutorily disqualified persons to effect security-based swaps on behalf of SBS Entities may mitigate compliance and counterparty risks and may facilitate competition among higher quality SBS Entities, enhancing integrity of security-based swap markets. At the same time, limits on disqualified person participation in security-based swap markets may involve costly business restructuring or costs of applying to the Commission for relief. As with the other economic effects already discussed, effects on efficiency, competition, and capital formation flow primarily from how the rule alters an SBS Entity's evaluation of the tradeoff between the value of an associated person's skill and expertise in effecting security-based swaps against the costs of applying for relief, and how the rule alters an SBS Entity's ultimate decision to seek relief.

As noted above, by providing a structured process and clarity as to the standard of review, proposed Rule of Practice 194 may conserve resources relative to the baseline for SBS Entities applying for relief under Section 15F(b)(6), and therefore create a more efficient process for SBS Entities that choose to apply. To the extent that the savings resulting from the proposed rule may encourage more SBS Entities to apply for relief, especially in the case of associated person entities, a greater number of SBS Entities may be able to effect security-based swaps without potentially costly business restructuring.

SBS Entities incur reputational and application costs of permitting

statutorily disqualified persons to effect or be involved in effecting security-based swaps, and weigh these costs against the level and substitutability of disqualified persons' skills and expertise. Should more SBS Entities apply for relief, a greater number of disqualified persons may seek employment and business opportunities in security-based swap markets. However, persons eligible to rely on paragraph (j) to proposed Rule of Practice 194, regarding disqualifications already reviewed by the Commission, the CFTC, an SRO or a registered futures association, may enjoy a competitive advantage over persons not eligible for the same treatment. Because SBS Entities would not need to expend resources filing an application, they may prefer associating with persons who can rely on proposed Rule of Practice 194(j) over their disqualified counterparts. If SBS Entities exhibit a preference for persons that can take advantage of proposed Rule of Practice 194(j), it could create competitive disparities among associated persons.

A temporary exclusion pending review by the Commission, the CFTC, an SRO or a registered futures association, set forth in paragraph (i) to proposed Rule of Practice 194, would enable SBS Entities to continue their security-based swap market participation without incurring the costs of reassigning or disassociating from disqualified persons. As a result, SBS Entities associating with entities that become subject to a statutory disqualification can continue dealing in security-based swaps without incurring costs of business restructuring until the disposition of the application.<sup>192</sup> SBS Entities that begin to associate with statutorily disqualified entities would be eligible for the same temporary relief, conditional on timeliness of the application. If the Commission denies the application under proposed Rule of Practice 194 related to an associated person entity that is subject to a statutory disqualification, the Commission may by order grant a temporary extension of the exclusion to enable the SBS Entity to become

<sup>192</sup> We note that with respect to applications for Commission review the proposed temporary exclusion is time limited. If the Commission has not rendered a decision within 180 days of filing a completed application under the Proposed Rule of Practice 194, SBS Entities will have 60 days to become in compliance with the general statutory prohibition. See proposed Rule of Practice 194(i)(1)(ii). If the Commission approves the application after the temporary exclusion has expired, SBS Entities will again be able to permit the disqualified associated entity to effect or be involved in effecting security-based swaps on their behalf.

compliant with the statutory prohibition in Exchange Act Section 15F(b)(6).<sup>193</sup> Broadly, this temporary exclusion may lower costs to SBS Entities of associating or beginning to associate with statutorily disqualified entities.

The overall effects of the temporary exclusion from the general statutory prohibition pending review are unclear. On the one hand, it may serve to mitigate potential disruptions should associated entities of a number of SBS Entities become disqualified, leading some SBS Entities to temporarily cease dealing activity pending Commission, CFTC, an SRO or registered futures association review, or to effect business restructuring. At the same time, the presence and magnitude of the potential market disruption is unclear, since other SBS Entities are likely to begin competing for the newly opened market share. The overall effects of this provision on security-based swap market quality and competition depend primarily on whether and which SBS Entities are able to win the newly opened market share in such cases.

Clarity about the items that the Commission will consider in making determinations may allow SBS Entities to make informed assessments about whether a particular application is likely to be approved or denied. Increased certainty about the process may, in turn, alter an SBS Entity's evaluation of its own cost-benefit tradeoff in determining whether to file an application for relief, enabling the entity to more efficiently expend resources.

Finally, while security-based swaps are important financial instruments that may facilitate the capital formation process, we preliminarily believe that the impact of proposed Rule of Practice 194 on capital formation will be *de minimis*. Given that nothing about the statute precludes either SBS Entities from seeking relief or the Commission from granting relief in the absence of a rule, and given the low expected incidence of statutory disqualification among natural persons associated with SBS Entities, we do not believe the rule will materially affect the ability of either issuers to raise capital or financial intermediaries to hedge their investments with issuers. Therefore, we do not expect the rule to have a material effect on capital formation, either positively or negatively.

### E. Rule Alternatives

In addition to proposed Rule of Practice 194, the Commission has considered five primary alternative

<sup>193</sup> See proposed Rule of Practice 194(i)(3).

approaches. We discuss these approaches below.

### 1. Relief for All Entities From Exchange Act Section 15F(b)(6)

The Commission has considered blanket relief from the general prohibition in Exchange Act Section 15F(b)(6) with respect to all associated person entities. Under this alternative, SBS Entities cross-registered as Swap Entities with the CFTC would experience potential economies of scope in associating with persons that are entities. Further, SBS Entities will avoid all costs of business restructuring if associated person entities become statutorily disqualified, or in the event of new associations with statutorily disqualified associated person entities effecting or involved in effecting security-based swaps on their behalf.

Relative to the proposed temporary exclusion approach, SBS Entities would be less constrained by the general statutory prohibition and would be able to associate with any and all disqualified entity persons in any capacity without applying for relief under Exchange Act Section 15F(b)(6) or under Rule of Practice 194. Further, the uniform entity exemption approach gives SBS Entities certainty about their ability to permit disqualified entity persons to effect or be involved in effecting security-based swaps, whereas the proposed temporary exclusion expires after 180 days, and SBS Entities have 60 days to conform to the general statutory prohibition if the Commission, the CFTC, an SRO or a registered futures association does not render a decision on the application within that timeframe.

At the same time, the counterparty and compliance risks under the uniform entity exemption approach may be greater than those under the proposed approach. If the Commission excludes all disqualified associated entities from the scope of the general statutory prohibition, the Commission would be unable to make an individualized determination under proposed Rule of Practice 194 about whether permitting an associated person entity that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of an SBS Entity is consistent with the public interest.<sup>194</sup> Further, statutory disqualification and an inability to continue associating with SBS Entities

<sup>194</sup> However, the Commission could, by order, censure, place limitations on the activities or functions of the associated person, or suspend or bar such person from being associated with an SBS Entity. See 15 U.S.C. 78o-1(l)(3) and Note 98, *supra*.

may create a disincentive against underlying misconduct for associated persons, and a blanket exception for disqualified associated persons that are entities may reduce the disincentive against misconduct.

The overall effects of this alternative on security-based swap markets are unclear. Under this alternative, disqualified persons would not undergo substantive review and all disqualified entity persons would be able to effect or be involved in effecting security-based swaps on behalf of SBS Entities, which may increase counterparty and compliance risks. However, SBS Entities associating with disqualified persons would not have to undergo business restructuring, the costs of which may flow through to counterparties, further mitigating the risk of disruptions.

### 2. A Modified Temporary Exclusion

The Commission could adopt a modified temporary exclusion, where if the Commission does not render a decision within 180 days the application would be considered granted. This alternative would effectively default to relief from the statutory prohibition for applications for Commission review, since SBS Entities would be able to permit disqualified associated entities to effect or be involved in effecting security-based swaps on their behalf, unless the Commission makes an individualized determination that it is not consistent with the public interest to enable them to do so within 180 days of the application being filed. This may benefit SBS Entities by lowering uncertainty about the need to restructure the business and disassociate from the disqualified entity person. However, it may lead some applications to be considered granted before the Commission is able to perform an individualized assessment of the facts of each case, particularly in complex cases that may require an extensive review. These modifications may benefit SBS Entities, but may allow some disqualified associated entities to be able to effect or be involved in effecting security-based swaps on behalf of SBS Entities where the Commission would not have deemed it consistent with the public interest to permit them to do so.

### 3. Relief for Non-Investment-Related Offenses

The Commission could also adopt the approach of automatically excepting SBS Entities that associate with statutorily disqualified persons if the matters that triggered the statutory disqualification were non-investment-related, while requiring SBS Entities to

apply for relief under the proposed rules for investment-related statutory disqualifications.<sup>195</sup> Such an approach would eliminate restructuring or application costs for SBS Entities associating with statutorily disqualified persons when statutory disqualification arises out of non-investment related offenses, which may increase competition among SBS Entity associated persons and attract new natural persons into the SBS Entity labor market. SBS Entities associating with persons statutorily disqualified for investment-related offenses would have to bear costs of disassociating or applying for relief and would have to compete with a greater number of SBS Entities that do not have to apply for relief.

Statutory disqualification and the potential inability to deal in various markets may present an incentive against misconduct, including non-investment-related misconduct. This alternative would also lower the information benefits of reviewing applications and supporting materials, including information concerning supervisory structure, terms of employment and other items, which will inform Commission understanding of SBS Entity associations and ongoing oversight. Finally, some statutory disqualification triggers that may not fall in the “investment related offense” category (e.g., thefts) may point to a higher risk of future misconduct, including violations of securities laws, federal rules and regulations thereunder. Uniformly excepting such statutorily disqualified associated persons without an opportunity for the Commission to review the circumstances of each case and to make a determination that allowing SBS Entities to permit them to effect security-based swaps is consistent with the public interest may pose risks to counterparties and security-based swap markets.

### 4. No Relief for CFTC, SRO, Registered Futures Association Review

The proposed rules allow SBS Entities to permit statutorily disqualified persons to effect or be involved in

<sup>195</sup> As discussed in the baseline, in a somewhat analogous scenario for broker dealers, 10 out of 24, or approximately 42% of MC-400 applications for relief for individuals received by FINRA in 2014 were for exclusively non-investment-related disqualifications. Over a 5 year period between 2010 and 2014, 2 out of 5 re-offenses by individuals were not investment-related (177 MC-400 applications have been received over the same time period). Reoffenses include subsequent regulatory actions and criminal offense convictions after previous approvals to associate pursuant to Rule 19h-1, 17 CFR 240.19h-1.

effecting security-based swaps on their behalf without an application to the Commission, if the associated person's membership, association, registration or listing as a principal has been granted or otherwise approved by the CFTC, an SRO or a registered futures association. The proposed approach also provides a time limited temporary exclusion for disqualified associated entities while their application before the CFTC, an SRO or a registered futures association is pending; the proposed exclusion expires 180 days after the filing of an application or initiation of a similar process, after which point SBS Entities have 60 days to conform with the general statutory prohibition. The Commission could adopt an alternative approach, under which such disqualified associated persons would not be automatically permitted to effect or be involved in effecting security-based swaps on behalf of SBS Entities, and would have to apply directly for a substantive review by the Commission under Rule of Practice 194. The temporary exclusion pending Commission review would apply as proposed.

This alternative approach would allow the Commission to review the facts and circumstances of each case and make an individualized public interest determination with respect to each disqualified associated person concerning whether they should be permitted to effect or be involved in effecting security-based swaps on behalf of SBS Entities, and under which conditions. If fewer SBS Entities choose to go through a separate review by the Commission, this alternative may result in a smaller number of disqualified associated persons effecting or involved in effecting security-based swaps. To the extent that statutory disqualification and terms and conditions of reassociation may indicate compliance and counterparty risks, this may improve compliance and counterparty protections for security-based swap market participants.

However, this alternative may increase costs for SBS Entities. Specifically, this alternative would require SBS Entities to incur the application costs under Rule of Practice 194 with respect to associated persons that have already been approved by the CFTC, SRO or a registered futures association, or costs of restructuring the business or disassociating from such persons altogether. If the application is denied, SBS Entities would need to restructure the business or disassociate from the associated person. In addition, in light of the high degree of integration among swap and security-based swap

markets and expected cross-registration, many SBS Entities are expected to transact across swap, security-based swap and reference security markets, and some SBS Entities may be relying on the same personnel and entities in effecting, for instance, single name and index CDS. This approach would limit SBS Entity flexibility in hiring and retaining disqualified associated persons where the SBS Entity believes the person's quality and expertise outweigh the reputational costs of associating with a disqualified person and where the CFTC, an SRO or a registered futures association has made a favorable finding with respect to the associated person.

The effects of this alternative on security-based swap markets will depend on the extent of reliance by SBS Entities on disqualified persons approved by the CFTC, an SRO or a registered futures association, magnitude of the above business restructuring costs, significance of bilateral counterparty relationships, and the severity of compliance and counterparty risks posed by disqualified associated persons. As discussed in earlier sections, we lack data or other information to quantify these effects with any degree of certainty.

#### 5. No Relief for Entities From Exchange Act Section 15(F)(b)(6)

Lastly, the Commission could establish a uniform prohibition on associated person entities subject to statutory disqualification effecting or being involved in effecting security-based swaps on behalf of SBS Entities. Under this approach, all disqualified associated entities not covered by the exemption in final registration rules would be barred from intermediating security-based swaps on behalf of SBS Entities. To the extent that past disqualifications can point to higher compliance and counterparty risks, this alternative could potentially strengthen counterparty protections. Further, the inability to participate in various markets due to disqualification disincentivizes misconduct. Adopting this approach would strengthen these incentive effects, which may improve compliance with federal securities laws, rules and regulations.

However, barring all disqualified associated entities from effecting or being involved in effecting security-based swaps on behalf of SBS Entities would impose costs of business restructuring for a number of SBS Entities, which may in turn affect market quality. In the event of a disqualification after the compliance date of the final registration rules, SBS

Entities would be required to cease intermediating security-based swaps and restructure their business to disassociate from all disqualified entities. If a number of entities associated with different SBS Entities become disqualified at the same time, a number of SBS Entities may become temporarily unable to effect security-based swaps due to disqualification. Currently, inter-dealer transactions account for over 60% of single-name CDS transactions, which reflects the central position of a small number of dealers, each of which may intermediate trades between many hundreds of counterparties. If some of the central dealers are temporarily unable to effect security-based swaps, higher transaction costs or market disruptions may occur. However, we note that other SBS Entities may step in to pick up the market share. The overall economic effects will depend on: (i) The costs and the required length of time for business restructuring; (ii) which SBS Entities would be able to pick up the newly available market share; and (iii) the relative importance of bilateral relationships between SBS Entities and counterparties.

Lastly, this alternative may decrease the number of entities seeking to associate with SBS Entities since disqualified entity persons will no longer be able to effect or be involved in effecting security-based swaps. Such disqualified entities may seek to associate with security-based swap market participants that are not required to register (entities falling within the *de minimis* exception set forth in Exchange Act Rule 3a71-2<sup>196</sup>).

The Commission is requesting comments regarding the economic analysis set forth here. To the extent possible, the Commission requests that market participants and other commenters provide supporting data and analysis with respect to the benefits, costs, and effects on competition, efficiency, and capital formation of adopting proposed Rule of Practice 194, or any reasonable alternatives.

Although the Commission is seeking comments on the economic analysis generally, the Commission is also soliciting comment on the following specific issues:

Q-53. Has the Commission accurately characterized the costs and benefits of proposed Rule of Practice 194? If not, why not? Should any of the costs or benefits be modified? What, if any, other costs or benefits should the Commission take into account?

<sup>196</sup> 17 CFR 240.3a-71-2.

Q-54. Has the Commission accurately characterized the effects on competition, efficiency, and capital formation arising from proposed Rule of Practice 194? If not, why not?

Q-55. Has the Commission reasonably estimated the application costs associated with proposed Rule of Practice 194? Has the Commission reasonably estimated the average number of applicants per year (with respect to both natural persons and entities)? Are there any other costs that the Commission should take into account regarding preparing, reviewing, and submitting an application under proposed Rule of Practice 194? If the application costs are too high, how specifically should the Commission modify proposed Rule of Practice 194 to reduce application costs?

Q-56. Is it a reasonable characterization that the effects of the rule on capital formation will be *de minimis*? If not, why not?

Q-57. Has the Commission accurately characterized the costs, benefits, and effects on competition, efficiency, and capital formation of the alternatives specified above? If not, why not? Should any of the costs or benefits be modified? What, if any, other costs or benefits should the Commission take into account?

Q-58. Are there other reasonable alternatives that the Commission should consider? What are the costs, benefits, and effects on competition, efficiency, and capital formation of any other alternatives?

## VI. Regulatory Flexibility Act Certification

### A. Regulatory Framework

The Regulatory Flexibility Act (“RFA”) <sup>197</sup> requires federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a) <sup>198</sup> of the Administrative Procedure Act, <sup>199</sup> 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.” <sup>200</sup> Section 605(b) of the RFA provides 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. <sup>201</sup>

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (i) 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, <sup>202</sup> or (ii) 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 Rule 17a-5(d) under the Exchange Act, <sup>203</sup> 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 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. <sup>204</sup>

Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following:

(i) For entities engaged in certain credit intermediation and related activities, entities with \$550 million or less in assets; <sup>205</sup>

(ii) for entities engaged in non-depository credit intermediation and certain other activities, entities with \$38.5 million or less in annual receipts; <sup>206</sup>

(iii) for entities engaged in financial investments and related activities, entities with \$38.5 million or less in annual receipts; <sup>207</sup>

(iv) for insurance carriers and entities engaged in related activities, entities with \$38.5 million or less in annual receipts, or 1,500 employees for direct property and casualty insurance carriers; <sup>208</sup> and

(v) for funds, trusts, and other financial vehicles, entities with \$32.5 million or less in annual receipts. <sup>209</sup>

SBA definitions of small businesses apply to a firm’s parent company and all affiliates as a single entity. <sup>210</sup>

### B. Assessment of Impact

Proposed Rule of Practice 194 would, if adopted, establish rules concerning an application by SBS Entity to the Commission for an order permitting an associated person that is a natural person and that is subject to a statutorily disqualification to effect or be involved in effecting security-based swaps on behalf of an SBS Entity. With respect to SBS Entities, based on feedback from market participants and our information about the security-based swap markets, the Commission continues to believe that (1) the types of entities that would engage in more than a *de minimis* amount of dealing activity involving security-based swap—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 be a “major security-based swap participant” would not be “small entities” for purposes of the RFA. <sup>211</sup>

### C. Certification and Request for Comment

For the foregoing reasons, the Commission certifies that the proposed Rule of Practice 194 would not, if adopted, have a significant economic impact on a substantial number of small entities for purposes of the RFA.

The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide supporting data to support the extent of the impact.

## VII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (“SBREFA”) <sup>212</sup> the Commission requests comment on the potential effect of proposed Rule of Practice 194 on the United States 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

<sup>197</sup> 5 U.S.C. 601 *et seq.*

<sup>198</sup> 5 U.S.C. 603(a).

<sup>199</sup> 5 U.S.C. 551 *et seq.*

<sup>200</sup> Although Section 601(b) of the RFA defines the term “small entity,” the statute permits the Commission to formulate its own definition. 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 Rule 0-10, 17 CFR 240.0-10. *See* Exchange Act Release No. 18451, 47 FR 5212 (Feb. 4, 1982).

<sup>201</sup> *See* 5 U.S.C. 605(b).

<sup>202</sup> *See* 17 CFR 240.0-10(a).

<sup>203</sup> *See* 17 CFR 240.17a-5(d).

<sup>204</sup> *See* 17 CFR 240.0-10(c).

<sup>205</sup> *See* 13 CFR 121.201 (Subsector 522).

<sup>206</sup> *See id.* at Subsector 522.

<sup>207</sup> *See id.* at Subsector 523.

<sup>208</sup> *See id.* at Subsector 524.

<sup>209</sup> *See id.* at Subsector 525.

<sup>210</sup> *See* 13 CFR 121.201 (“The number of employees or annual receipts indicates the maximum allowed for a concern *and its affiliates* to be considered small.”) (emphasis added); *see also* 13 CFR 121.103 (listing how SBA determines affiliation).

<sup>211</sup> *See* Cross-Border Adopting Release, 79 FR at 47368.

<sup>212</sup> Public Law 104-121, Tit. II, 110 Stat. 857 (1996).

innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

### VIII. Statutory Authority

The Commission is proposing Rule of Practice 194 pursuant to Exchange Act Section 15F(b)(4) and (6),<sup>213</sup> as added by Section 764(a) of the Dodd-Frank Act, and Exchange Act Section 23(a).<sup>214</sup>

In accordance with the foregoing, the Securities and Exchange Commission is proposing to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

#### PART 201—RULES OF PRACTICE

■ 1. The authority citation for subpart D is revised to read as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77h-1, 77j, 77s, 77u, 77sss, 77ttt, 78(c)(b), 78d-1, 78d-2, 78l, 78m, 78n, 78o(d), 78o-3, 78o-10(b)(6), 78s, 78u-2, 78u-3, 78v, 78w, 80a-8, 80a-9, 80a-37, 80a-38, 80a-39, 80a-40, 80a-41, 80a-44, 80b-3, 80b-9, 80b-11, 80b-12, 7202, 7215, and 7217.

■ 2. Add § 201.194 to subpart D to read as follows:

**§ 201.194. Applications by security-based swap dealers or major security-based swap participants for statutorily disqualified associated persons to effect or be involved in effecting security-based swaps.**

A security-based swap dealer or major security-based swap participant making an application under this section should refer to Appendix A to § 201.194—Note Concerning Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons To Effect or Be Involved In Effecting Security-Based Swaps.

(a) *Scope of rule.* Applications by a security-based swap dealer or major security-based swap participant for the Commission to permit an associated person (as provided in 15 U.S.C. 78c(a)(70)) to effect or be involved in effecting security-based swaps on behalf of a registered security-based swap dealer or major security-based swap participant, or to change the terms and conditions thereof, may be made pursuant to this section where the associated person is subject to a statutory disqualification and thereby prohibited from effecting or being involved in effecting security-based swaps on behalf of a security-based swap dealer or major security-based swap participant under Exchange Act Section 15F(b)(6) (15 U.S.C. 78o-10(b)(6)).

(b) *Required showing.* The applicant shall make a showing that it would be consistent with the public interest to permit the person associated with the security-based swap dealer or major security-based swap participant who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant.

(c) *Form of application—natural persons.* Each application with respect to an associated person that is a natural person that is subject to a statutory disqualification shall be supported by a written statement, signed by a knowledgeable person authorized by the security-based swap dealer or major security-based swap participant, which addresses the items set forth in paragraph (d) of this section. The application shall be filed pursuant to Rules of Practice 151, 152 and 153 (17 CFR 201.151, 201.152 and 201.153). Each application shall include as exhibits:

(1) A copy of the order or other applicable document that resulted in the associated person being subject to a statutory disqualification;

(2) An undertaking by the applicant to notify promptly the Commission in writing if any information submitted in support of the application becomes materially false or misleading while the application is pending;

(3) A copy of the questionnaire or application for employment specified in 17 CFR 240.15Fb6-2(b), with respect to the associated person; and

(4) If the associated person has been the subject of any proceeding resulting in the imposition of disciplinary sanctions during the five years preceding the filing of the application or is the subject of a pending proceeding by the Commission, the Commodity Futures Trading Commission, any federal or state regulatory or law enforcement agency, registered futures association (as provided in 7 U.S.C. 21), foreign financial regulatory authority, registered national securities association, or any other self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)), or commodities exchange, or any court, the applicant should include a copy of any order, decision, or document issued by the court, agency, self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)) or other relevant authority involved.

(d) *Written statement—natural persons.* The written statement required by paragraph (c) of this section shall address each of the following, to the extent applicable:

(1) The associated person's compliance with any order resulting in statutory disqualification, including whether the associated person has paid fines or penalties, disgorged monies, made restitution or paid any other monetary compensation required by any such order;

(2) The associated person's employment during the period subsequent to becoming subject to a statutory disqualification;

(3) The capacity or position in which the person subject to a statutory disqualification proposes to be associated with the security-based swap dealer or major security-based swap participant;

(4) The terms and conditions of employment and supervision to be exercised over such associated person and, where applicable, by such associated person;

(5) The qualifications, experience, and disciplinary history of the proposed supervisor(s) of the associated person;

(6) The compliance and disciplinary history, during the five years preceding the filing of the application, of the applicant;

(7) The names of any other associated persons at the applicant who have previously been subject to a statutory disqualification and whether they are to be supervised by the associated person;

(8) Any relevant courses, seminars, examinations or other actions completed by the associated person subsequent to becoming subject to a statutory disqualification to prepare for his or her participation in the security-based swap business;

(9) Notwithstanding the event resulting in statutory disqualification, the applicant should provide a detailed statement of why the associated person should be permitted to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant, including what steps the associated person or applicant has taken, or will take, to ensure that the statutory disqualification does not negatively impact upon the ability of the associated person to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant in compliance with the applicable statutory and regulatory framework;

(10) Whether the associated person has been involved in any litigation during the five years preceding the filing of the application concerning investment or investment-related activities or whether there are any unsatisfied judgments outstanding

<sup>213</sup> 15 U.S.C. 78o-10(b)(4), (6).

<sup>214</sup> 15 U.S.C. 78w(a).

against the associated person concerning investment or investment-related activities, to the extent not otherwise covered by paragraph (d)(9) of this section. If so, the applicant should provide details regarding such litigation or unsatisfied judgments; and

(11) Any other information that the applicant believes to be material to the application.

(e) *Form of application—other persons.* Each application with respect to an associated person that is not a natural person and that is subject to a statutory disqualification shall be supported by a written statement, signed by a knowledgeable person authorized by the security-based swap dealer or major security-based swap participant, which addresses the items set forth in paragraph (f) of this section. The application shall be filed pursuant to Rules of Practice 151, 152 and 153 (17 CFR 201.151, 201.152 and 201.153). Each application shall include as exhibits:

(1) A copy of the order or other applicable document that resulted in the associated person being subject to a statutory disqualification;

(2) An undertaking by the applicant to notify immediately the Commission in writing if any information submitted in support of the application becomes materially false or misleading while the application is pending;

(3) Organizational charts of the associated person, if available;

(4) Policies and procedures relating to the conduct resulting in the statutory disqualification that the associated person has in place to ensure compliance with the federal or state securities laws, the Commodity Exchange Act, the rules or regulations thereunder, or the rules of the Municipal Securities Rulemaking Board, or any self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)), or any foreign regulatory authority, as applicable;

(5) If the associated person has been the subject of any proceedings resulting in the imposition of disciplinary sanctions during the five years preceding the filing of the application or is the subject of a pending proceeding by the Commission, the Commodity Futures Trading Commission, any federal or state regulatory or law enforcement agency, registered futures association (as provided in 7 U.S.C. 21), foreign financial regulatory authority, registered national securities association, or any other self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)), or commodities exchange, or any court, the applicant should include a copy of any order, decision, or

document issued by the court, agency, self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)) or other relevant authority involved, if available; and

(6) The names of any natural persons employed by the associated person that are subject to a statutory disqualification and that would effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant. For any such natural person, the applicant should indicate if the individual is an officer, partner, direct or indirect owner of the associated person.

(f) *Written statement—other persons.* The written statement required by paragraph (e) of this section shall address each of the following, to the extent applicable:

(1) General background information about the associated person, including number of employees; number and location of offices; the type(s) of business(es) in which the associated person is engaged; and self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)) memberships of the associated person and the effective dates of membership, if applicable;

(2) The associated person's compliance with any order resulting in a statutory disqualification, including whether the associated person has paid fines or penalties, disgorged monies, made restitution or paid any other monetary compensation required by any such order;

(3) The capacity or position in which the person subject to a statutory disqualification proposes to be associated with the security-based swap dealer or major security-based swap participant;

(4) A description of whether, with respect to the statutory disqualification and the sanctions imposed, the associated person was ordered to undertake any changes to its organizational structure or policies and procedures set forth in paragraph (e)(4) of this section. To the extent that such changes were mandated, describe what changes were mandated and whether the associated person has implemented them;

(5) Notwithstanding the conduct resulting in a statutory disqualification, the applicant should provide a detailed statement of why the associated person should be permitted to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant, including what steps the associated person or applicant have taken, or will take, to ensure that the statutory disqualification does not

negatively impact upon the ability of the associated person to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant in compliance with the applicable statutory and regulatory framework;

(6) The compliance and disciplinary history, during the five years preceding the filing of the application, of the applicant;

(7) Whether the associated person has been involved in any litigation during the five years preceding the filing of the application concerning investment or investment-related activities or whether there are any unsatisfied judgments outstanding against the associated person concerning investment or investment-related activities, to the extent not otherwise covered by paragraph (f)(6) of this section. If so, the applicant should provide details regarding such litigation or unsatisfied judgments; and

(8) Any other information that the applicant believes to be material to the application.

(g) *Prior applications or processes.* In addition to the information specified above, any person making an application under this rule shall provide any order, notice or other applicable document reflecting the grant, denial or other disposition (including any dispositions on appeal) of any prior application or process concerning the associated person:

(1) Pursuant to this section;

(2) Pursuant to Rule of Practice 193 (17 CFR 201.193);

(3) Pursuant to Investment Company Act Section 9(c) (15 U.S.C. 80a-9(c));

(4) Pursuant to Section 19(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(d)), Rule 19h-1 under the Securities Exchange Act of 1934 (17 CFR 240.19h-1), or a proceeding by a self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)) for a person to become or remain a member, or an associated person of a member, notwithstanding the existence of a statutory disqualification; or

(5) By the Commodity Futures Trading Commission or a registered futures association (as provided in 7 U.S.C. 21) for registration, including as an associated person, or listing as a principal, notwithstanding the existence of a statutory disqualification, including:

(i) Any order or other document providing that the associated person may be listed as a principal or registered as an associated person of a futures commission merchant, retail foreign exchange dealer, introducing broker,

commodity pool operator, commodity trading advisor, or leverage transaction merchant, or any person registered as a floor broker or a floor trader, notwithstanding that the person is subject to a statutory disqualification from registration under Section 8a(2) or 8a(3) of the Commodity Exchange Act (7 U.S.C. 12a(2), (3)); or

(ii) Any determination by a registered futures association (as provided in 7 U.S.C. 21) that had the associated person applied for registration as an associated person of a swap dealer or a major swap participant, notwithstanding statutory disqualification, the application would have been granted or denied.

(h) *Notification to applicant and written statement.* In the event an adverse recommendation is proposed by Commission staff with respect to an application made pursuant to this rule, the applicant shall be so advised and provided with a written statement of the reasons for such recommendation. The applicant shall then have 30 days thereafter to submit a written statement in response.

(i) *Temporary exclusion for other persons.* (1) Unless otherwise ordered by the Commission, or the Commission, Commodity Futures Trading Commission, self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)) or a registered futures association (as provided in 7 U.S.C. 21) has previously denied membership, association, registration or listing as a principal with respect to the associated person, the security-based swap dealer or major security-based swap participant shall be excluded from the prohibition in Section 15F(b)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)(6)) with respect to an associated person that is not a natural person and that is subject to a statutory disqualification as follows:

(i) For 30 days following the associated person becoming subject to a statutory disqualification or 30 days following the person that is subject to a statutory disqualification becoming an associated person of a security-based swap dealer or major security-based swap participant; and

(ii) For 180 days following the filing of a complete application pursuant to this section and a notice pursuant to paragraph (i)(2) by a security-based swap dealer or major security-based swap participant if the application and notice are filed within the time period specified in paragraph (i)(1)(i), or until such time the Commission makes a determination on such application within the 180-day time period; provided that where the Commission

does not render a decision within 180 days following the filing of such application, the applicant shall have 60 days to comply with the prohibition in Section 15F(b)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)(6)); or

(iii) For 180 days following the filing of a complete application with, or initiation of a process by, the Commodity Futures Trading Commission, self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)) or a registered futures association (as provided in 7 U.S.C. 21) with respect to the associated person for the membership, association, registration or listing as a principal, where such application has been filed or process started prior to or within the time period specified in paragraph (i)(1)(i) of this section and a notice has been filed with the Commission pursuant to (i)(2) of this section within the time period specified in paragraph (i)(1)(i); provided that where the Commodity Futures Trading Commission, self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)) or a registered futures association (as provided in 7 U.S.C. 21) does not render a decision or renders an adverse decision with respect to the associated person within the 180-day time period, the applicant shall have 60 days to comply with the prohibition in Section 15F(b)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)(6)).

(2) A security-based swap dealer or major security-based swap participant shall be excluded from the prohibition in Section 15F(b)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)(6)) as provided in paragraph (i)(1)(ii) or (iii) of this section where the security-based swap dealer or major security-based swap participant has filed a notice with the Commission setting forth the name of the security-based swap dealer or major security-based swap participant and the name of the associated person that is subject to a statutory disqualification, and attaching as an exhibit to the notice a copy of the order or other applicable document that resulted in the associated person being subject to a statutory disqualification.

(3) Where the Commission denies an application pursuant to this section with respect to an associated person that is not a natural person, the Commission may provide by order an extension of the exclusion provided for in paragraph (i)(1)(ii) of this section as is necessary or appropriate to allow the applicant to comply with the prohibition in Section

15F(b)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)(6)).

(j) *Notice in lieu of an application.* (1) A security-based swap dealer or major security-based swap participant may permit a person associated with it that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, without making an application pursuant to this section, where the conditions in paragraph (j)(2) of this section are met, and where:

(i) The person has been admitted to or continued in membership, or participation or association with a member, of a self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)), notwithstanding that such person is subject to a statutory disqualification under Section 3(a)(39)(A) through (F) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(39)(A) through (F));

(ii) The person is a natural person and has been granted consent to associate pursuant to the Rule of Practice 193 (17 CFR 201.193);

(iii) The person has been permitted to effect or be involved in effecting security-based swaps on behalf of a security-based swap dealer or major security-based swap participant pursuant to this section; or

(iv) The person has been registered as, or listed as a principal of, a futures commission merchant, retail foreign exchange dealer, introducing broker, commodity pool operator, commodity trading advisor, or leverage transaction merchant, registered as an associated person of any of the foregoing, registered as or listed as a principal of a swap dealer or major swap participant, or registered as a floor broker or floor trader, notwithstanding that the person is subject to a statutory disqualification under Sections 8a(2) or 8a(3) of the Commodity Exchange Act (7 U.S.C. 12a(2), (3)), and the person is not subject to a Commission bar or suspension pursuant to Sections 15(b), 15B, 15E, 15F or 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b), 78o-4, 78o-7, 78o-10, 78q-1), Section 9(b) of the Investment Company Act of 1940 (15 U.S.C. 80a-9(b)) or Section 203(f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(f)).

(2) A security-based swap dealer or major security-based swap participant may permit a person associated with it that is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf, without making an application pursuant to this section, as provided in paragraph (j)(1) of this section, subject to the following conditions:

(i) All matters giving rise to a statutory disqualification under Section 3(a)(39)(A) through (F) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(39)(A) through (F)) have been subject to a process where the membership, association, registration or listing as a principal has been granted or otherwise approved by the Commission, Commodity Futures Trading Commission, self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)) or a registered futures association (as provided in 7 U.S.C. 21);

(ii) The terms and conditions of the association with the security-based swap dealer or major security-based swap participant are the same in all material respects as those approved in connection with a previous order, notice or other applicable document granting the membership, association, registration or listing as a principal, as provided in paragraph (j)(1) of this section;

(iii) Where the associated person is a natural person, the security-based swap dealer or major security-based swap participant has filed a notice with the Commission, setting forth, as appropriate:

(A) The name of the security-based swap dealer or major security-based swap participant;

(B) The name of the associated person subject to a statutory disqualification;

(C) The name of the associated person's prospective supervisor(s) at the security-based swap dealer or major security-based swap participant;

(D) The place of employment for the associated person subject to a statutory disqualification; and

(E) Identification of any agency, self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)) or a registered futures association (as provided in 7 U.S.C. 21) that has indicated its agreement with the terms and conditions of the proposed association, registration or listing as a principal; and

(iv) Where the associated person is not a natural person, the security-based swap dealer or major security-based swap participant has filed a notice with the Commission setting forth:

(A) The name of the security-based swap dealer or major security-based swap participant;

(B) The name of the associated person that is subject to a statutory disqualification; and

(C) Identification of any agency, self-regulatory organization (as provided in 15 U.S.C. 78c(a)(26)) or a registered futures association (as provided in 7 U.S.C. 21) that has indicated its agreement with the terms and conditions of the proposed association, registration or listing as a principal.

**Appendix A to § 201.194—Note Concerning Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons To Effect or Be Involved In Effecting Security-Based Swaps**

(a) Under Section 15F(b)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)(6)), except to the extent otherwise specifically provided by rule, regulation, or order of the Commission, it shall be unlawful for a security-based swap dealer or a major security-based swap participant to permit any person associated with a security-based swap dealer or a major security-based swap participant who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant, if the security-based swap dealer or major security-based swap participant knew, or in the exercise of reasonable care should have known, of the statutory disqualification.

(b) In accordance with the authority granted in Section 15F(b)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)(6)), this rule governs applications to the Commission by a security-based swap dealer or major security-based swap participant for the Commission to issue an order to permit an associated person of a security-based swap dealer or major security-based swap participant who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant.

(c) Applications made pursuant to this rule must show that it would be consistent with the public interest to permit the associated person of the security-based swap dealer or major security-based swap participant to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant. In addition to the information specifically required by the rule, with respect to associated persons that are natural persons, applications should be supplemented, where appropriate, by written statements of individuals who are competent to attest to the associated person's character, employment performance, and other relevant information. In addition to the information required by the rule, the Commission staff

may request supplementary information to assist in the Commission's review. Intentional misstatements or omissions of fact may constitute criminal violations of 18 U.S.C. 1001, *et seq.* and other provisions of law. The Commission will not consider any application that attempts to reargue or collaterally attack the findings that resulted in the statutory disqualification.

(d) The nature of the supervision that an associated person that is a natural person will receive or exercise as an associated person with a registered entity is an important matter bearing upon the public interest. In meeting the burden of showing that permitting the associated person to effect or be involved in effecting security based swaps on behalf of the security-based swap dealer or major security-based swap participant is consistent with the public interest, the application and supporting documentation must demonstrate that the terms or conditions of association, procedures or proposed supervision, are reasonably designed to ensure that the statutory disqualification does not negatively impact upon the ability of the associated person to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant in compliance with the applicable statutory and regulatory framework.

(e) Normally, the applicant's burden of demonstrating that permitting the associated person to effect or be involved in effecting security based swaps on behalf of the security-based swap dealer or major security-based swap participant is consistent with the public interest will be difficult to meet where the associated person that is a natural person is to be supervised by, or is to supervise, another statutorily disqualified individual. In addition, where the associated person wishes to become the sole proprietor of a registered entity and thus is applying to the Commission to issue an order permitting the associated person to effect or be involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant notwithstanding an absence of supervision, the applicant's burden will be difficult to meet. The associated person may be limited to association in a specified capacity with a particular registered entity and may also be subject to specific terms and conditions.

By the Commission.

Dated: August 5, 2015.

**Brent J. Fields,**  
Secretary.

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