

CLIENT ALERT

SEC Proposes Rules Related to Security-Based Swaps Requiring Public Reporting of Large Positions, Imposing Anti-Fraud and Anti-Manipulation Requirements and Prohibiting Actions to Exert Undue Influence over CCOs

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On December 15, 2021, the Securities and Exchange Commission (“SEC”) voted 3-2 to propose three rules under the Securities Exchange Act of 1934 (“Exchange Act”) concerning security-based swaps.¹ Proposed Rule 10B-1 would require any person having a position in security-based swaps to file publicly a schedule disclosing information regarding the person’s security-based swap positions and related positions in the referenced debt, equity or loans if the person’s security-based swap holdings and other specified holdings in the referenced instrument and related instruments exceed the proposed rule’s reporting thresholds. Proposed Rule 9j-1, which is re-proposed from 2010, would prohibit specified activities constituting fraud, manipulation, and deception in connection with, among other things, the purchase and sale of

¹ Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions, Exchange Act Rel. No. 93784 (Dec. 15, 2021) (the “Proposing Release”), available [here](#); SEC Proposes Rules to Prevent Fraud in Connection With Security-Based Swaps Transactions, to Prevent Undue Influence over CCOs and to Require Reporting of Large Security-Based Swap Positions, SEC Press Release No. 2021-259 (Dec. 15, 2021) (the “Press Release”), available [here](#).

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security-based swaps and entry into any rights thereunder. Proposed Rule 15Fh-4(c) would prohibit certain actions deemed to be exertion of undue influence over the chief compliance officer (“CCO”) of a security-based swap dealer or major security-based swap participant (“SBS Entities”).

The proposed rules are aimed at fulfilling the SEC’s mandate to regulate security-based swaps in Title VII of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).²

While Commissioners Caroline Crenshaw and Allison Herren Lee provided statements in support of the proposed rules,³ Commissioners Hester M. Peirce and Elad L. Roisman dissented.⁴ Commissioner Peirce stated that the reporting rules “may serve to squelch legitimate market activity” and would appear to be “premature” given that new requirements for security-based swap transaction reporting go into effect in February 2022 and the impact of that reporting is yet to be realized or analyzed.⁵ Commissioner Roisman similarly stated that it was not clear that the large amount of information to be reported under proposed Rule 10B-1 would be effective in achieving the stated goals.⁶

I. Reporting Requirements for Large Positions in Security-Based Swaps

Rule 10B-1 would require any person, or group of persons, who owns security-based swap positions above specified threshold amounts, to file promptly a statement containing the information required by Schedule 10B on EDGAR.⁷ Calculation of holdings for purposes of the threshold amounts requires inclusion of the security-based swap position, holdings of the referenced instrument, and holdings of other specified instruments providing exposure to the referenced instrument. The SEC indicated in the Proposing Release that such transparency could provide both regulators and the

² See Commissioner Caroline Crenshaw, Statement on Re-Proposed Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps (Dec. 15, 2021), available [here](#).

³ *Id.*; Commissioner Allison Herren Lee, Standing Up the Security-Based Swap Regime: Statement on Proposed Rules for Antifraud, Position Reporting and CCO Support (Dec. 15, 2021), available [here](#).

⁴ Commissioner Hester M. Peirce, Dissenting Statement on Proposed Security-Based Swap Rules (Dec. 15, 2021), available [here](#); Commissioner Elad L. Roisman, Dissenting Statement on Proposed Security-Based Swaps Rules (Dec. 15, 2021), available [here](#). On December 20, 2021, Commissioner Roisman resigned from the SEC and indicated that he expected to leave prior to the end of January 2022.

⁵ See Commissioner Hester M. Peirce, Dissenting Statement on Proposed Security-Based Swap Rules, *supra* note 4 (also expressing concern that prohibiting attempted (in addition to actual) fraudulent behavior could create uncertainty for market participants who may be concerned about how the SEC or counterparties will “assess even innocuous conduct in retrospect,” and that “manufactured credit events” and other opportunistic strategies involving security-based swaps may not be serious enough to warrant regulation). Transaction reporting for security-based swaps has been required since November 8, 2021, with public dissemination to begin on February 14, 2022. See SEC Approves Registration of First Security-Based Swap Data Repository; Sets the First Compliance Date for Regulation SBSR, SEC Press Release No. 2021-80 (May 7, 2021), available [here](#).

⁶ Commissioner Elad L. Roisman, Dissenting Statement on Proposed Security-Based Swaps Rules, *supra* note 4.

⁷ As discussed below, certain of the thresholds are calculated by reference to holdings in the referenced security and other related instruments.

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public with advance notice that certain market participants are building large positions, facilitate risk management, inform pricing of security-based swaps, and generally allow market participants to act in an informed manner to protect their own interests and limit potentially harmful consequences.⁸

Under the proposed rule, security-based swap counterparties who trigger the reporting requirements would be required to disclose, among other information: (i) the applicable security-based swap position (including the direction, *i.e.*, long or short); (ii) positions in any security or loan underlying the security-based swap position; (iii) other security-based swaps on other securities of the same referenced issuer; (iv) positions in other instruments relating to the security-based swap position or the referenced security or loan or group or index of securities or loans; and (v) specified identifying information regarding the reporting person.⁹ Reportable security-based swaps are limited to security-based swaps: (i) subject to transaction reporting under Rule 908 of 17 CFR 242.900 through 242.909 (“Regulation SBSR”); or (ii) entered into by a person that also holds an interest in the securities underlying the security-based swap (or is deemed to be the beneficial owner of such securities for purposes of Section 13(d) of the Exchange Act and the rules and regulations thereunder) if (1) the issuer of referenced securities is established as an entity in the U.S. and has its principal place of business in the U.S. or (2) the referenced security is part of a class of securities registered under Section 12 or Section 15(d) of the Exchange Act. The proposed rule would apply to both cleared and uncleared security-based swaps.¹⁰

The term “security-based swap” is not defined in the proposed rule but is defined generally in Section 3(a)(68) of the Exchange Act to mean an agreement, contract or transaction that is a “swap” as defined in Section 1a of the Commodity Exchange Act and is based on: (i) a narrow-based security index, including an interest therein or on the value thereof; (ii) a single security or loan, including any interest therein or on the value thereof; or (iii) the occurrence, nonoccurrence, or extent of the occurrence of an event relating to a single issuer of a security or issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer.

The threshold amounts that would trigger reporting vary based on the type of security-based swap and are calculated based on security-based swap and, in some cases, other related holdings of the reporting person.

For security-based swaps that are credit default swaps (“CDS”), the threshold for a CDS position is the lesser of: (i) a long notional amount of \$150 million, calculated by subtracting the notional amount of any long positions in a deliverable debt security underlying a security-based swap from the long notional amount of the security-based swap position; (ii) a short notional amount of \$150 million; or (iii) a gross notional amount of \$300 million.¹¹ As noted, to the extent that a person

⁸ See Press Release.

⁹ See proposed Rule 10B-1(b)(3).

¹⁰ See Proposing Release at 62.

¹¹ See proposed Rule 10B-1(b)(1)(i).

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holds long CDS exposure, a long hedge position will reduce the notional value for purposes of determining whether the \$150 million threshold is met, but will not reduce the maximum gross notional amount for purposes of the \$300 million threshold.¹²

For security-based swap positions based on debt securities that are not CDS, the threshold is a gross notional amount of \$300 million.¹³

For security-based swap positions based on equity securities, the threshold is the lesser of: (i) a gross notional amount of \$300 million; provided, however, that if the gross notional amount of the security-based swap position exceeds \$150 million, the calculation of the gross notional amount of the security-based swap position shall also include the value of any equity securities owned by the holder of the security-based swap position (based on the most recent closing price of shares), plus the delta-adjusted notional amount of any options, security futures, or any other derivative instruments based on the same class of equity securities;¹⁴ or (ii) a security-based swap equivalent position that represents more than 5% of a class of equity securities; provided, however, that if the security-based swap equivalent position represents more than 2.5% of a class of equity securities, the calculation of the security-based swap equivalent position must also include in the numerator all of the underlying equity securities owned by the holder of the security-based swap position, as well as the number of shares attributable to any options, security futures, or any other derivative instruments based on the same class of equity securities.¹⁵

A security-based swap position exceeding the threshold amount would be required to be reported on Schedule 10B, together with holdings in the referenced instrument and related instruments, no later than the end of the first business day following the execution of the security-based swap. Under the proposed rule, a person who has previously filed a Schedule 10B must file an amendment to the Schedule promptly if any material change occurs in the facts set forth in the

¹² The SEC provides the following example of how these provisions are intended to operate: If a person held \$125 million in bonds on ABC Corporation and purchased \$200 million in CDS on those bonds, those two positions would offset each other, such that the net security-based swap position would be \$75 million, and reporting pursuant to proposed Rule 10B-1 would not be required since the net exposure is below \$150 million. However, if a person held \$250 million in bonds on ABC Corporation and purchased \$325 million in CDS on those bonds, the person would be required to report that position pursuant to proposed Rule 10B-1 because the gross security-based swap position exceeds \$300 million, even though those two positions would offset each other to create a net \$75 million exposure. See Proposing Release at 75.

¹³ See proposed Rule 10B-1(b)(1)(ii).

¹⁴ Proposed Rule 10B-1(b)(6) defines the term "delta" as the ratio of (i) the change in the value of a derivative instrument to (ii) the change in the value of the reference equity security, calculated daily if it is not fixed for a particular security-based swap. The SEC explained that the reason for imposing the lesser gross notional threshold is to prevent a holder of security-based swaps from building exposure in a referenced security through other types of instruments in order to avoid the reporting requirement for security-based swaps. See Proposing Release at 79-80.

¹⁵ See proposed Rule 10B-1(b)(1)(iii). The SEC noted that the 2.5% threshold was necessary in order to address the possibility that a person would keep its security-based swap equivalent position below the 5% threshold while also building up a position in the underlying equity securities or related instruments. See Proposing Release at 79-80.

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previous filing, including, without limitation, any material increase or decrease in the security-based swap position or a decline in the security-based swap position below the applicable threshold amount.¹⁶ For these purposes, a “material” change in the position would be an acquisition or disposition equal to 10% or more of the previously disclosed, security-based swap position.¹⁷ A person reporting on Schedule 10B would not be required to file the actual contracts governing the security-based swaps, although it must provide a “brief description” of the contracts or relationships regarding the security-based swaps included in the security-based swap position and other instruments disclosed on the Schedule.¹⁸ Filers may incorporate by reference information that is already publicly available on EDGAR at the time the Schedule 10B is filed (e.g., shares reported on Schedule 13D).¹⁹

The SEC does not believe that the large trader position reporting requirements of proposed Rule 10B-1 are duplicative of Regulation SBSR transaction reporting requirements. Regulation SBSR governs regulatory reporting of security-based swap transactions to security-based swap data repositories (“SBSDRs”) and public dissemination of some of that data.²⁰ The Proposing Release highlights that Regulation SBSR requires real-time public reporting to SBSDRs and public dissemination of security-based swap transaction data, but not position data as contemplated by the proposed rule. In addition, Regulation SBSR only requires reporting of security-based swap transactions, while the proposed rule would require reporting of positions in security-based swaps and in the referenced securities and related positions, as described above.²¹

The collapse of investment firm, Archegos Capital Management (“Archegos”), appears to have motivated the proposal of this rule.²² On March 26, 2021, Archegos defaulted on a number of security-based swaps, causing several large banks to incur over \$10 billion in losses.²³ Archegos held large long positions in security-based swaps structured as total return swaps on equity.²⁴ The SEC noted that the lack of public information about Archegos’ total market position meant that security-based swap counterparties and other market participants were not aware of Archegos’ risk of default.²⁵ The SEC

¹⁶ Proposing Release at 82-83.

¹⁷ *Id.*

¹⁸ *Id.* at 86-87.

¹⁹ *Id.*

²⁰ *See id.* at 23-24.

²¹ *Id.*

²² *See* Chair Gary Gensler, Statement on Exchange Act 10B and Rule 9j-1 (Dec. 15, 2021), available [here](#); Commissioner Allisson Herren Lee, Standing Up the Security-Based Swap Regime: Statement on Proposed Rules for Antifraud, Position Reporting and CCO Support, *supra* note 3; Commissioner Caroline Crenshaw, Statement on Re-Proposed Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps, *supra* note 2.

²³ *See* Board of Governors of the Federal Reserve System, The Federal Reserve Reminds Firms of Safe and Sound Practices for Counterparty Credit Risk Management in Light of the Archegos Capital Management Default, SR 21-19 (Dec. 10, 2021), available [here](#).

²⁴ Total return swaps include non-CDS debt-based security swaps, equity-based security swaps, and mixed swaps. *See* Proposing Release at 117.

²⁵ *Id.* at 118.

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also noted that the leverage embedded in the security-based swaps held by Archegos accelerated the losses experienced by Archegos and ultimately led to large losses by security-based swap counterparties and prime brokers.²⁶

The SEC expressed the view that reporting in the manner required by the proposed rule should alleviate the information asymmetry that results from a party attaining exposure to a security, loan or narrow index of those instruments through security-based swaps rather than through investment in the referenced instruments themselves.²⁷

The approach taken by the SEC in proposed Rule 10B-1 to address the perceived information asymmetries relating to security-based swaps notably does not seek to change existing guidance regarding the definition of beneficial ownership of securities, as applied under Sections 13(d) and (g) of the Exchange Act and the rules thereunder. Under the current rules, most security-based swap agreements do not confer beneficial ownership over their reference securities on the party that is “long,” absent an intent to evade the reporting requirements of Sections 13(d) and (g) of the Exchange Act. Security-based swap agreements generally provide that the swaps are to be settled only in cash, do not confer voting or investment rights with respect to the reference securities, and do not require that the “short” counterparty hedge its position by holding the reference securities. The Dodd-Frank Act granted authority to the SEC to determine when security-based swaps confer beneficial ownership and directed the SEC to address the court’s decision in *CSX Corporation v. The Children’s Investment Fund Management (UK) LLP* suggesting that cash-settled, security-based swaps could confer beneficial ownership to the long counterparty.²⁸ The *CSX Corporation* decision involved a 2008 proxy contest for seats on the CSX Corporation board of directors and entry by a dissident hedge fund into total return swaps on voting securities of the company. The court determined that the hedge fund beneficially owned CSX Corporation shares by virtue of the swaps, as a result of the anti-evasion provision of Rule 13d-3(b). The SEC clarified in 2011 that the beneficial ownership rules in effect at that time continued to apply to security-based swaps.²⁹ New proposed Rule 10B-1 preserves the approach taken by the SEC in 2011 and addresses reporting without changing the *status quo* with respect to beneficial ownership of hedges or securities referenced by security-based swaps.

²⁶ See Commissioner Allison Herren Lee, Standing Up the Security-Based Swap Regime: Statement on Proposed Rules for Antifraud, Position Reporting and CCO Support, *supra* note 3.

²⁷ Proposing Release at 62-63.

²⁸ *CSX Corp. v. Children’s Inv. Fund Mgmt. (UK) LLP*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008), affirmed without opinion by *CSX Corp. v. Children’s Inv. Fund Mgmt. (UK) LLP*, 292 F. App’x 133 (2d Cir. 2008).

²⁹ See Beneficial Ownership Reporting Requirements and Security-Based Swaps, Exchange Act Release No. 64087 (Mar. 17, 2011) (stating that the reproposal of the existing beneficial ownership requirements by the SEC “is neither intended nor expected to change any existing administrative or judicial application or interpretation of the rules”).

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II. Anti-Fraud and Anti-Manipulation in Security-Based Swaps Transactions

Proposed Rule 9j-1 would prohibit fraudulent, deceptive, or manipulative conduct in connection with transactions in security-based swaps, including misconduct in connection with the exercise of any right or performance of any obligation under a security-based swap.³⁰ Proposed Rule 9j-1 follows the approach proposed in 2010, but is expanded in various aspects, as noted below.

a. Anti-Fraud and Anti-Manipulation Provisions Under Rule 9j-1(a)

As proposed, Rule 9j-1(a) would make it unlawful for any person, directly or indirectly to: (i) purchase or sell, or attempt to induce the purchase or sale of, any security-based swap; (ii) effect any transaction in, or attempt to effect any transaction in, any security-based swap; (iii) take any action to exercise any right, or any action related to performance of any obligation, under any security-based swap, including in connection with any payments, deliveries, rights, or obligations or alterations of any rights thereunder; or (iv) terminate (other than on its scheduled maturity date) or settle any security-based swap, in connection with which such person:

- (1) employs or attempts to employ any device, scheme, or artifice to defraud or manipulate; or
- (2) makes or attempts to make any untrue statement of a material fact, or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or
- (3) obtains or attempts to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
- (4) engages or attempts to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

The SEC noted that the provisions combine the anti-fraud and anti-manipulation provisions of Section 10(b) of the Exchange Act, Rule 10b-5 under the Exchange Act, and Section 17(a) of the Securities Act of 1933 (the "Securities Act"), and apply them to security-based swaps. The provisions further prohibit any person from manipulating or attempting to manipulate the price or valuation of any security-based swap, or any payment or delivery related to the security-based swap. Consistent with the 2010 version and Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and Section 17(a)(1) of the Securities Act, proposed Rules 9j-1(a)(1) and (2) would require scienter in order to breach the provisions.

³⁰ See Press Release.

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Proposed Rules 9j-1(a)(3) and (4), on the other hand, would not require scienter but only a showing of negligence, consistent with Section 17(a)(2) and (3) of the Securities Act.

In proposing the anti-fraud and anti-manipulation rules applicable to security-based swaps, the SEC acknowledged that the existing anti-fraud and anti-manipulation provisions of the federal securities laws, including Sections 9 and 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as Section 17(a) of the Securities Act, already apply to security-based swaps because they fall within the definition of “security” in each of those statutes. The SEC noted, however, that the scope of those provisions was directed at actions in connection with the “purchase” or “sale” of security-based swaps and the scope of the proposed rules would encompass a broader scope and timeline, including, without limitation, early termination of transactions and posting of collateral.³¹

To address concerns expressed about the 2010 version regarding the potential breadth of conduct encompassed by the definitions of “purchase” and “sale,”³² the SEC proposed two limited safe harbors. The safe harbors address situations in which a counterparty to a security-based swap is required to take certain actions while in possession of material non-public information (“MNPI”). Under the first safe harbor, a person would not be liable under proposed Rule 9j-1(a) solely as a result of being aware of MNPI, so long as the person can demonstrate that: (i) the security-based swap was entered into before the person became aware of such MNPI; and (ii) entry into the security-based swap and its terms do not violate proposed Rule 9j-1(a).³³ The second safe harbor would exculpate a person from liability when effecting security-based swap transactions pursuant to a bilateral or multilateral portfolio compression exercise³⁴ while aware of MNPI relating to the security-based swap so long as: (i) the transactions are consistent with the terms of the portfolio compression exercise as it relates to the transactions, risk tolerances of participating persons, and methodology; and (ii) all such terms were agreed to by all participants of the exercise.³⁵

³¹ Proposing Release at 34-35.

³² See, e.g., Letter from Stuart J. Kaswell, Managed Funds Association (“MFA”), at 2-10 (Dec. 23, 2010); Letter from Stuart J. Kaswell, MFA, at 3-9 (Mar. 29, 2011); and Letter from Kenneth E. Bentsen, Jr., Securities Industry and Financial Markets Association and Robert G. Pickel, International Swaps and Derivatives Association, at 9-10, 13 (Dec. 23, 2010), available [here](#).

³³ Proposing Release at 42.

³⁴ A bilateral portfolio compression exercise occurs when two counterparties wholly terminate or change the notional value of security-based swaps and replace them with other security-based swaps whose combined notional value is less than the combined notional value of the terminated security-based swaps. 17 C.F.R. § 240.15Fi-1(a). A multilateral portfolio compression exercise occurs when multiple security-based swap counterparties wholly terminate or change the notional value of some or all of the security-based swaps and replace them with other security-based swaps whose combined notional value is less than the combined notional value of the terminated security-based swaps. 17 C.F.R. § 240.15Fi-1(j).

³⁵ Proposing Release at 43-44.

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Proposed Rule 9j-1(a) would also prohibit an “attempt” to disseminate false financial information or data in connection with the sale of a security-based swap or insider trading in a security-based swap.³⁶ In her dissent, Commissioner Hester M. Peirce expressed concern regarding the prohibition of “attempted” fraud, deceit, and manipulation.³⁷

Finally, proposed Rule 9j-1(a) would prevent misconduct related to posting of collateral and payments or deliveries under security-based swaps.³⁸ It would also prohibit fraud and manipulation with respect to trading in the referenced instrument.³⁹

b. Prohibition on Price Manipulation Under Rule 9j-1(b)

Proposed Rule 9j-1(b) would prohibit price manipulation and attempted price manipulation, similar to CFTC Rule 180.2.⁴⁰ Specifically, proposed Rule 9j-1(b) would make it unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price or valuation of any security-based swap, or any payment or delivery related thereto.

The SEC indicated in the Proposing Release that it had been motivated to propose Rule 9j-1(b), in part, by market developments in recent years concerning manufactured credit events or other opportunistic strategies in the CDS market, including situations where a party intentionally distorts any payment related to a security-based swap for the benefit of a counterparty. Such strategies generally involve CDS buyers or sellers taking steps to avoid, trigger, delay, accelerate, decrease, and/or increase payouts on CDS.⁴¹

c. Liability Under Rule 9j-1(c) and Rule 9j-1(d) in Connection with the Purchase or Sale of a Security

Proposed Rule 9j-1 also would impose liability for trading while in possession of MNPI. Subsections (c) and (d) of proposed Rule 9j-1 would impose liability on market participants for effecting a fraudulent scheme through the purchase or sale of a referenced security, rather than the purchase or sale of the security-based swap, and vice versa, while in possession of MNPI.⁴²

³⁶ Proposed Rule 9j-1(a)(1) and (2). *See also* Proposing Release at 30-32.

³⁷ Proposing Release at 30-32.

³⁸ *Id.* at 43-44.

³⁹ *Id.*

⁴⁰ CFTC Rule 180.2 makes it unlawful for any person, directly or indirectly, to manipulate or attempt to manipulate the price of any swap, or of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity. 17 C.F.R. § 180.2.

⁴¹ Proposing Release at 14-15.

⁴² *Id.* at 49.

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III. Preventing Undue Influence over Chief Compliance Officers

Proposed Rule 15Fh-4(c) would prohibit personnel of SBS Entities from taking actions to coerce, mislead, or otherwise interfere with the SBS Entity's CCO.⁴³ Specifically, the proposed rule would make it unlawful for any officer, director, supervised person, or employee of an SBS Entity, or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence an SBS Entity's CCO in the performance of their duties under the federal securities laws or the rules and regulations thereunder.⁴⁴ The SEC provided as an example of unlawful coercion submission of false documentation to the CCO in order to avoid disclosing the build-up of a large security-based swap position that would require public reporting.⁴⁵

IV. Conclusion

The proposal of Rules 10B-1, 9j-1 and 15Fg-4(c) reflects the current SEC's focus on regulating security-based swaps and addressing systemic failures involving security-based swaps.

⁴³ *Id.* at 20.

⁴⁴ See proposed Rule 15Fh-4(c).

⁴⁵ Proposing Release at 55-56.

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