



December 19, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants; RIN 3235-AL05.

Dear Ms. Murphy:

Better Markets, Inc.¹ appreciates the opportunity to comment on the above-captioned Proposed Rules (“Proposed Rules”)² of the Securities and Exchange Commission (“SEC”). The Proposed Rules would establish the registration requirements of security-based swap dealers (“SBS Dealers”) and major security-based swap participants (“MSBSPs”) (collectively “SBS Entities”), in accordance with Section 764(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).³

INTRODUCTION

Registration of SBS Entities is a crucial component of an effective regulatory regime governing security-based swaps. Robust registration procedures are necessary to establish industry accountability and to protect the public from entities lacking the requisite integrity or capability to deal in security-based swaps or to hold substantial positions in those instruments.

Section 764 of the Dodd-Frank Act provides that “[i]t shall be unlawful for any person to act as an [SBS Dealer or MSBSP] unless the person is registered . . . with the Commission.”⁴ That section also gives the SEC discretion over the application process for registration and establishes a continual reporting obligation for these SBS Entities.⁵ Consistent with the statutory mandate, the SEC’s Proposed Rules detail the registration requirements of SBS Entities and provide forms to assist applicants in the registration process.

¹ Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

² Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 Fed. Reg. 65,784 (Oct. 24, 2011) (to be codified at 17 C.F.R. pts. 240 and 249) (hereinafter “Proposing Release”).

³ The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁴ Section 764(a) of the Dodd-Frank Act.

⁵ Section 764(b) of the Dodd-Frank Act.

However, although the Proposed Rules would implement a registration system that is simple and efficient, the approach taken is ineffective and relies too much not just on the industry, but on each entity that seeks registration. As proposed, the rules would merely serve as a notification to the Commission by self-interested applicants that they have judged themselves capable of acting as SBS Entities. Specifically, the SEC proposes to rely on an SBS Entity's senior officer to accurately and truthfully certify that the entity has the operational, financial, and compliance capabilities to act as an SBS Entity. Additionally, without establishing licensing requirements for associated persons, the SEC proposes to rely on the SBS Entity's certification that no associated person who is effecting or involved in effecting security-based swaps on behalf of the entity is statutorily disqualified. Both of these areas of the Proposed Rules are inadequate and must be significantly enhanced to establish a more effective regulatory regime and to create a barrier to entry for unfit or unqualified entities and individuals.

In short, the SEC's Proposed Rules would put the public and the markets entirely at the mercy of each financial entity, in the hope that every one of them will be honest and accurate. This is simply too much to ask when there is so much money to be made and the conflict between self-interest and self-reporting is so great. The financial collapse of 2008 starkly confirmed the inadequacy of industry self-regulation, particularly without strong oversight and aggressive enforcement to protect the public and the markets. Any final rule must include strong independent criteria for registration buttressed by oversight and sanctions for violations.

SUMMARY OF COMMENTS

To strengthen the Proposed Rules and provide for an effective regulatory regime for SBS Entities and their associated persons, the following changes are necessary:

- The SEC should independently investigate SBS Entities to determine whether or not they are fit to be registered.
- If the SEC determines not to engage in an independent review of each applicant, the SEC must at least strengthen the Proposed Rules to avoid total regulatory reliance on industry. To do so, the Proposed Rules must:
 - Require an independent external audit of each SBS Entity as part of the registration process;
 - Strengthen and define the standards an SBS Entity must meet for certification;
 - Require SBS Entities to retain and submit to the SEC a description of and supporting documentation relating to the auditing procedure, as well as an explanation as to why the entity meets the requisite standards; and
 - Require certifications to be updated either annually or when the SBS Entity amends its application forms.

- The SEC must establish a licensing regime to investigate associated persons before permitting them to effect or be involved in effecting security-based swaps on behalf of an SBS Entity.

COMMENTS

I. The SEC should independently investigate SBS entities to determine whether or not they are fit to be registered.

As written, the Proposed Rules would require a “knowledgeable senior officer [to] certify on Form SBSE-C that, after due inquiry, he or she has reasonably determined that the [SBS Entity] has the operational, financial, and compliance capabilities to act as [an SBS Entity].”⁶ Once the SEC receives this form and the rest of the completed application, the SEC would then, without knowing exactly how the entity has the requisite capabilities, generally grant the applicant registration. Only afterward and only if the SEC determines the entity poses a sufficiently great risk to investors and the market would staff engage in examinations.

This process is unacceptable because it requires the SEC to trust a self-interested and profit-motivated industry to assess its own ability to function fairly, efficiently, and lawfully as an SBS Entity. Such reliance on the regulated industry in the registration process is certain to result in lower standards in the fitness and operational capabilities of SBS Entities, to the detriment of investors and the markets. An independent review by the SEC of each applicant seeking to act as an SBS Entity is therefore essential to address this problem.

Requiring SEC investigations of SBS Entities prior to their grant of registration would not only minimize this reliance on industry, but would also confer a number of additional important benefits. It would harmonize SBS Entity registration with other registration regimes; ensure that those who are not also registered under other regimes do not totally evade investigation; guarantee that all applicants are held to the same standards; and provide protection to the clients of SBS Entities and their counterparties.

As mentioned in the Proposing Release, financial industry registrants are usually subject to an “in depth review by the Commission and its staff, or . . . SROs, **prior to** granting registration. . . .”⁷ The U.S. Commodity Futures Trading Commission (“CFTC”), through the National Futures Association (“NFA”), also conducts background checks on registrants prior to granting full registration.⁸ Moreover, the CFTC’s proposed companion rule, Registration of Swap Dealers and Major Swap Participants, would require NFA to conduct a background check of swap dealers and major swap participants.⁹ By requiring a similar review of SBS Entities by the SEC, the Proposed Rules would promote consistency

⁶ Proposing Release, 76 Fed. Reg. 65,821 (Proposed Rule 15Fb2-1(b)).

⁷ Proposing Release, 76 Fed. Reg. 65,789-90 (emphasis added).

⁸ See e.g., 17 CFR 3.1 *et. seq.*

⁹ Registration of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71,379, 71,382 (Nov. 23, 2010).

across the financial industry and ensure that SBS Entities are subject to the same regulatory treatment as other registrants.

To do otherwise would enable and, indeed, encourage regulatory arbitrage. The Proposed Rules would create the perverse incentive for market participants to become solely SBS Entities, thereby evading the standards other registrants are required to fulfill.

Because the category of SBS Entities encompasses more than broker-dealers, investment advisors, and others subject to registration requirements under other SEC regimes, there would be entities that, under the Proposed Rules, would not be subject to **any** pre-registration investigation. These outlying entities, such as banks acting as SBS Dealers, would be able to evade all the parallel registration requirements. Consequently, any investigation of these entities would occur, if at all, only after the SEC determines that they are posing a sufficient risk to the financial markets. This very limited post-registration review, only **after** the entity actually poses a sufficient risk, is insufficient, leaving the markets and public vulnerable to incompetent or unethical businesses and risking financial tragedy before the regulators have time to react.

Moreover, requiring the SEC, rather than just an officer of each individual SBS Entity, to conduct a pre-registration investigation would independently ensure that each entity has the same capacity and level of integrity required to deal in, or hold substantial positions in, security-based swaps. A self-certification process would inherently involve a degree of subjectivity. Senior officers of SBS Entities conducting the certification and review may have different and biased beliefs as to whether the entity has sufficient working capital, liquidity, compliance procedures, and other capabilities necessary to act as an SBS Entity. While a pre-registration investigation by the SEC does not eliminate subjectivity, it would ensure that each entity is attaining the same level of fitness and that the review is unbiased. Additionally, the SEC would be able to develop, and change as appropriate, specific internal guidelines to assist its review.

Lastly, a pre-registration investigation by the agency would actually provide protection to investors, customers of, and counterparties to an SBS Entity. The Proposing Release states that the senior officer certification is designed to provide "comfort."¹⁰ However, self-certification by a biased, profit-motivated industry provides no comfort or protection. Ignoring conflicts of interest does not eliminate them.

Market participants, even with access to Form SBSE-C, would only know that the entity believed it could act as an SBS Entity. The recent financial crisis highlighted the pervasive belief among Wall Street firms that they can do virtually anything and do it well. The crisis proved that this belief, no matter how genuinely or fervently held, was no indicator of actual competency. An independent, pre-registration review of SBS Entities by the SEC would help assure market participants that SBS Entities are subject to independent oversight and that they, in fact, possess the minimum qualifications necessary to deal in, and hold substantial positions in, security-based swaps.

¹⁰ Proposing Release, 76 Fed. Reg. 65,789.

II. *If the SEC determines not to engage in an independent review of each applicant, the SEC must strengthen the Proposed Rules to avoid total regulatory reliance on industry.*

If the SEC determines not to establish the thorough, uniform, and independent registration review process that is essential in this new market segment, then it must, at a minimum, strengthen the Proposed Rules and not rely totally on industry compliance.

a. *The Proposed Rules must require an independent external audit of each SBS Entity as part of the registration process.*

The Proposed Rules attempt to provide flexibility by declining to prescribe a single method for senior officers to employ when assessing the capabilities of the SBS Entity prior to certification as to those capabilities.¹¹ However, this flexibility is provided at the expense of an effective registration regime. To counter the subjective bias of self-certification based on internal review, the SEC must require an external independent audit-type process. This more reliable process would help ensure that the registration regime prevents unqualified, inept, and dishonest would-be SBS Entities from adversely affecting the financial system. Additionally, requiring an independent outside auditor to conduct a review of an SBS Entity would provide greater assurances to market participants that the entity actually has the requisite capabilities.

b. *The Proposed Rules must strengthen and define the standards an SBS Entity must meet for certification.*

The Proposed Rules decline to define the “operational, financial, and compliance capabilities” that the senior officer must certify to on form SBSE-C.¹² Rather, the Proposing Release refers to broad concepts described in other proposed rules that the SEC expects will be part of the senior officer review. Additionally, the Proposing Release asks whether the rules should instead require a senior officer to certify that “to the best of his or her knowledge, after due inquiry, the security-based swap dealer or major security-based swap participant has developed and implemented written policies and procedures reasonably designed to prevent violation of federal securities laws, the rules thereunder, and applicable self-regulatory organization rules.”¹³

First, the Proposed Rules must define “operational, financial, and compliance capabilities.” Doing so will provide clarity and an objectively verifiable test, which would reduce discretion and bias on the part of the reviewer as well as the certifier. Although the Commission references other proposed rules to assist in explaining these capabilities, that is insufficient. To the extent that those proposed rules are changed, or worse vacated by the courts, these cross-references would become meaningless.

¹¹ Proposing Release, 76 Fed. Reg. 65,791.

¹² Proposing Release, 76 Fed. Reg. 65,789.

¹³ Proposing Release, 76 Fed. Reg. 65,791 (Q-21).

The Proposed Rules should explicitly list factors to be taken into account in determining each capability. To account for factors that should be considered, but which the Commission is, at present, unaware of, the Proposed Rules should also provide for a catchall category of relevant considerations. In determining which factors to include, the SEC should consider other proposed rules, regulations, standards, and self-regulatory organization (“SRO”) rules that would be applicable to SBS Entities. If no independent pre-registration review by the SEC is required, then the self-certification process must be as clear and robust as possible.

Second, the senior officer should also be required to certify that to the best of his or her knowledge, after due inquiry, the SBS Entity has developed and implemented written policies and procedures reasonably designed to prevent violation of federal securities laws, the rules thereunder, and applicable self-regulatory organization rules. Because operational, financial, and compliance capabilities do not necessarily encompass requisite written policies and procedures, and because both categories are critical aspects of an SBS Entity’s qualifications, a senior officer should certify to each. Moreover, requiring certification as to each will stress the importance of the policies and procedures. At the very least, establishing written policies and procedures should be one requirement that each SBS Entity must satisfy to demonstrate its compliance capabilities.

c. The Proposed Rules must require SBS Entities to retain and submit to the SEC a description of and supporting documentation relating to the auditing procedure, as well as an explanation as to why the entity meets the requisite standards.

As a new, previously unregulated class of registrants, SBS Entities may vary widely in their respective business models and practices. The SEC notes in its Proposing Release that the Commission will need to gain experience with these new registrants.¹⁴ To gain this experience, provide for enhanced registration review, and ensure applicants engage in a “deliberate and thoughtful self-assessment,”¹⁵ the Proposed Rules must require SBS Entities to retain and submit to the SEC: (1) a description of the auditing procedure, (2) the supporting documentation relating thereto, and (3) an explanation of why the entity meets the requisite standards.

This requirement would provide the SEC with valuable information on new registrants so that it may recalibrate its registration procedures and regulations as needed. For example, the SEC could assess whether to further tailor its entity-specific forms and whether the “operational, financial, and compliance capabilities” should encompass additional considerations to be evaluated by the senior officer. Moreover, the information submitted would help the SEC and its Office of Compliance Inspections and Examinations better determine which SBS Entity would pose a risk meriting enhanced examination.

Most importantly, requiring SBS Entities to retain and submit this information would encourage applicants to diligently assess their operations and ensure senior officers

¹⁴ Proposing Release, 76 Fed. Reg. 65,786.

¹⁵ Proposing Release, 76 Fed. Reg. 65,789.

consider all relevant aspects of the entity prior to certification. The Proposed Rules would, apparently, only require an SBS Entity “to maintain a manually signed copy of [the senior officer certification form] as part of its books and records until at least three years after the certification was filed with the [SEC].”¹⁶ Although the senior officer must certify that he or she documented the review process, the Proposed Rules fail to require this documentation be submitted to the SEC or even retained. If the Commission intended another rule to provide for this recordkeeping requirement, it is unclear. Nevertheless, the Proposed Rules must explicitly state that an SBS Entity must retain and submit to the SEC: (1) a description of the auditing procedure, (2) the supporting documentation relating thereto, and (3) an explanation of why the entity meets the requisite standards.

d. The Proposed Rules must require certifications to be updated either annually or whenever the SBS Entity amends its application forms.

As proposed, the rules would only require the SBS Entity to amend its Form SBSE, Form SBSE-A, and Form SBSE-BD, as applicable, to correct any information it determines is, or has become, inaccurate for any reason.¹⁷ In contrast, the senior officer certification provided on Form SBSE-C would only have to be submitted once, in the initial application. Requiring an annual re-certification or at least a re-certification when application forms are amended, would encourage continuous industry accountability and promote effective oversight. The Commission must not allow SBS Entities to make a one-time self-assessment of their fitness and capacity to deal and hold positions in security-based swaps.

III. The SEC must establish a licensing regime to investigate associated persons before permitting them to effect or be involved in effecting security-based swaps on behalf of an SBS Entity.

The Proposed Rules would require SBS Entities, after assessing relevant employment application criteria, to certify that no associated person is statutorily disqualified.¹⁸ While this requirement tracks the explicit language of 764(b) of the Dodd-Frank Act,¹⁹ it does not go far enough. To ensure that the persons associated with SBS Entities are also subject to essential and heightened regulatory standards, the SEC must establish a licensing regime for associated persons.

Financial regulators have often relied on the traditional licensing model in other regimes to verify that associated persons possess a minimum level of fitness and integrity to conduct their respective businesses. For example, the Financial Industry Regulatory Authority (FINRA) investigates, tests, and licenses brokers and associated persons. The NFA has a similar regime for associated persons of registered futures commission merchants, introducing brokers, retail foreign exchange dealers, commodity pool operators, and registered commodity trading advisors.

¹⁶ Proposing Release, 76 Fed. Reg. 65,789, note 25.

¹⁷ Proposing Release, 76 Fed. Reg. 65,822 (Proposed Rule 15Fb2-3).

¹⁸ Proposing Release, 76 Fed. Reg. 65,824 (Proposed Rule 15Fb6-1).

¹⁹ Section 764(b)(6) of the Dodd-Frank Act.

It is necessary and appropriate to subject associated persons of SBS Entities to a similar regime. In fact, given the complexities of the derivatives markets, the demonstrable risks associated with it, and the clear need for a strong and comprehensive regulatory regime to govern it, it is essential for the Commission to require associated persons of SBS Entities to be screened and licensed. The Commission cannot allow these associated persons unfettered access to the security-based swaps market and merely rely on later rule violations to disqualify them.

CONCLUSION

Better Markets is aware of the pragmatic concerns facing the SEC. However, complete and total reliance on industry participants who are inevitably conflicted is simply not a sufficient basis for regulation. The Commission must establish a strong registration regime for SBS Entities and their associated persons. An effective regulatory regime for a previously unregulated industry is crucial and the Proposed Rules must be amended as described above. We hope these comments are helpful in your consideration of the Proposed Rules.

Sincerely,



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