

SEC Adopts Rule of Practice 194

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Washington D.C., Dec. 19, 2018 —

The Securities and Exchange Commission today announced that it has voted to adopt Rule of Practice 194. In general, this rule creates a transparent, efficient, and comprehensive process for a registered security-based swap dealer or major security-based swap participant, collectively known as SBS Entities, to apply to the Commission for relief from the statutory disqualification prohibition found in Exchange Act Section 15F(b)(6). Rule of Practice 194 also provides an exclusion for an SBS Entity from the prohibition in Exchange Act Section 15F(b)(6) with respect to associated persons entities, consistent with the Commodity Futures Trading Commission’s (CFTC) approach with respect to the statutory prohibition for swap entities.

“Not only does adopting Rule of Practice 194 mark a significant milestone in the SEC’s implementation of Title VII of the Dodd-Frank Act, but like the Commission’s recent issuance of a Statement concerning certain provisions of its business conduct standards for SBS Entities, Rule of Practice 194 further reflects the Commission staff’s shared commitment with their counterparts at the CFTC, to achieve greater harmonization of Title VII rules,” said SEC Chairman Jay Clayton.

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FACT SHEET

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 Swap Transactions (Rule of Practice 194)

Action

The Securities and Exchange Commission has adopted Rule of Practice 194, which creates a process for a registered SBS Entity to apply to the Commission for an order permitting an associated person that is a natural person 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 Commission finds, subject to certain conditions, that such association is consistent with the public interest. Rule of Practice 194 also provides an exclusion for an SBS Entity from the prohibition in Exchange Act Section 15F(b)(6) with respect to associated persons entities.

Background

In 2010, Congress passed Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which established a comprehensive framework for regulating the over-the-counter swaps markets. Section 764 of the Dodd-Frank Act, among other things, added Section 15F(b)(6) to the Exchange Act, which makes it unlawful, unless otherwise provided by rule, regulation or order of the Commission, for an SBS Entity 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 if the SBS Entity knew, or in the exercise of reasonable care should have known, of the statutory disqualification.

On August 5, 2015, the Commission proposed Rule of Practice 194 to establish a process by which an SBS Entity could 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. As discussed in the Commission’s proposal, the federal securities laws provide various procedural avenues that allow certain registered entities to associate, where warranted, with persons subject to a statutory disqualification or other bar, including for example the Commission’s Rule of Practice 193 and FINRA’s eligibility proceedings. The Commission modeled proposed Rule of Practice 194 on these existing processes. The Commission requested comment on all aspects of the proposal as well as two alternative approaches, and received comments in response.

Highlights

The Commission is adopting Rule of Practice 194 largely as proposed, with certain modifications. In particular, the Commission is adopting the following provisions in Rule of Practice 194:

- Paragraph (a) of Rule of Practice 194, which defines the scope of the rule and provides a process for submitting applications by an SBS Entity seeking an order of the Commission to permit an associated person that is a natural person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity.
- Paragraph (b) of Rule of Practice 194, which specifies the required showing for an application. For the Commission to issue an order granting relief under Rule of Practice 194, an SBS Entity is 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.
- Paragraph (c) of Rule of Practice 194, which establishes an exclusion from the general prohibition in Exchange Act Section 15F(b)(6) with respect to all associated person entities.
- Paragraphs (d) and (e) of Rule of Practice 194, which specify the form of the application with respect to an associated person that is a natural person and the items to be addressed in the written statement with the application.
- Paragraph (f) of Rule of Practice 194, which requires an applicant to provide as part of any 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 Rule of Practice 194 and other similar processes.
- Paragraph (g) of Rule of Practice 194, which provides 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 will be provided with a written statement of the reasons for the Commission staff's preliminary recommendation, and the applicant will have 30 days to submit a written statement in response.
- Paragraph (h) of Rule of Practice 194, which provides that, where certain conditions are met, an SBS Entity does 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. Specifically, paragraph (h) of Rule of Practice 194 allows 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 (g., FINRA), or a registered futures association (e.g., the 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 paragraph (h), the SBS Entity will be permitted to file a notice with the Commission (in lieu of an application).

Next Steps

Rule of Practice 194 is effective 60 days after publication in the Federal Register. However, the compliance date for the SBS Entity registration rules depends on the adoption of two pending rules, and will be 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 or the compliance date of final rules establishing recordkeeping and reporting requirements for SBS Entities.

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