

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 242

[Release No. 34-64018; File No. S7-27-10]

RIN 3235-AK74

Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule; reopening of comment period.

SUMMARY: The Securities and Exchange Commission (“Commission”) is reopening the period for public comment on proposed Regulation MC under the Securities Exchange Act of 1934 (“Exchange Act”), which is designed to mitigate potential conflicts of interest at clearing agencies that clear security-based swaps (“security-based swap clearing agencies”), security-based swap execution facilities (“SB SEFs”), and national securities exchanges that post or make available for trading security-based swaps (“SBS exchanges”). The proposal was originally published in Securities Exchange Act Release No. 63107 (October 14, 2010), 75 FR 65882 (October 26, 2010) (“Regulation MC Proposing Release”). The Commission is reopening the period for public comment to solicit further comment on Regulation MC in light of other more recent proposed rulemakings that concern conflicts of interest at security-based swap clearing agencies and SB SEFs.

DATES: Comments should be received on or before April 29, 2011.

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/proposed.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File No. S7-27-10 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. S7-27-10. This file number should be included on the subject line if e-mail 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 website (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, N.E., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Proposals relating to security-based swap clearing agencies: Catherine Moore, Senior Special Counsel, at (202) 551-5710; and Joseph P. Kamnik, Special Counsel, at (202) 551-5710, Office of Clearance and Settlement, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010; proposals relating to SB SEFs and SBS exchanges: Nancy J. Burke-Sanow,

Assistant Director, at (202) 551-5620; Susie Cho, Special Counsel, at (202) 551-5639; Sarah Schandler, Special Counsel, at (202) 551-7145; Iliana Lundblad, Attorney-Advisor, at (202) 551-5871; and Jasmin Sethi, Attorney-Advisor, at (202) 551-5781, Office of Market Supervision, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION:

I. Introduction

The Commission proposed Regulation MC pursuant to Section 765 of the Dodd Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) to mitigate conflicts of interest with respect to security-based swap clearing agencies, SB SEFs, and SBS exchanges.¹ Section 765(a) of the Dodd-Frank Act provides that the Commission shall adopt rules, which may include numerical limits on the control of, or the voting rights with respect to, any security-based swap clearing agency, or on the control of any SB SEF or SBS exchange, by certain specified entities.² Under Section 765(b) of the Dodd-Frank Act, the Commission shall adopt such rules if it determines that they are necessary or appropriate to improve the governance of, or to mitigate systemic risk, promote competition or mitigate conflicts of interest in connection with a security-based swap dealer’s or major security-based swap participant’s conduct of business with, a security-based swap clearing agency, SB SEF, or SBS exchange and in which such

¹ The President signed the Dodd-Frank Act (Pub. L. No. 111-203, H.R. 4173) into law on July 21, 2010.

² See Pub. L. No. 111-203, Section 765(a). The entities specified in Section 765(a) (collectively, “Specified Entities”) include a bank holding company with total consolidated assets of \$50 billion or more, a nonbank financial company supervised by the Board of Governors of the Federal Reserve System, an affiliate of such bank holding company or nonbank financial company, a security-based swap dealer, a major security-based swap participant, or a person associated with a security-based swap dealer or a major security-based swap participant.

security-based swap dealer or major security-based swap participant has a material debt or equity investment.³

In the Regulation MC Proposing Release, the Commission identified conflicts of interest that may arise when a small number of participants, including participants that are Specified Entities, exercise undue control or influence over a security-based swap clearing agency, SB SEF or SBS exchange.⁴ To address these potential conflicts of interest, and pursuant to Section 765 of the Dodd-Frank Act, the Commission proposed certain restrictions in Regulation MC with respect to the ownership and voting interests in and the governance of security-based swap clearing agencies, SB SEFs and SBS exchanges. Specifically, the Commission proposed two alternative rules for security-based swap clearing agencies that would impose different degrees of voting and governance restrictions on such entities⁵ and one set of rules that would impose ownership and governance limitations on SB SEFs and SBS exchanges.⁶

³ See Pub. L. No. 111-203, Section 765(b).

⁴ Specifically, the Commission noted that these participants, for competitive or commercial reasons, may have an incentive to limit access by other participants to security-based swap clearing agencies, SB SEFs and SBS exchanges; to limit the scope of products cleared through security-based swap clearing agencies or traded on SB SEFs and SBS exchanges; to lower the risk management controls at security-based swap clearing agencies; and to put the commercial interests of the SB SEF or SBS exchange or the SB SEF's or SBS exchange's owners ahead of the SB SEF's or SBS exchange's market oversight responsibilities. See Regulation MC Proposing Release, 75 FR at 65884-65893.

⁵ Proposed Rule 701(a) of Regulation MC sets forth the "Voting Interest Focus Alternative," which would create a limitation on ownership and voting of voting interests for participants of a security-based swap clearing agency to no more than 20% on an individual basis and, in the aggregate, no more than 40% ("aggregate cap"). Proposed Rule 701(a) would also limit members' participation in the governance of the security-based swap clearing agency by requiring that at least 35% of the security-based swap clearing agency's board of directors ("board") and committees authorized to act on behalf of such board, including the risk committee, be composed of independent directors. The nominating committee of the security-based swap clearing agency's board would be required to be composed of a majority of independent directors. See Regulation MC Proposing Release, 75 FR at 65894-65899.

In the Regulation MC Proposing Release, the Commission sought commenters' views with respect to the identified conflicts of interest and its proposed rules that are designed to mitigate those conflicts. The public comment period for proposed Regulation MC closed on November 26, 2010. As of March 1, 2011, the Commission has received 100 comment letters relating to proposed Regulation MC.⁷ The Commission also received 6 comment letters relating to Section 765 of the Dodd-Frank Act that were received in response to the Commission's

Proposed Rule 701(b) of Regulation MC sets forth the "Governance Focus Alternative," which would create a limitation on ownership of voting interests for participants of a security-based swap clearing agency to no more than 5% on an individual basis but would impose no aggregate cap. Proposed Rule 701(b) would also limit members' participation in the governance of the security-based swap clearing agency by requiring that at least a majority of the security-based swap clearing agency's board and committees authorized to act for such board, including the risk committee, be composed of independent directors. The nominating committee of the security-based swap clearing agency's board would be required to be composed solely of independent directors. See Regulation MC Proposing Release, 75 FR at 65899-65903.

⁶ Proposed Rule 702(b) of Regulation MC would impose a 20% limitation on ownership and voting of voting interests in a SB SEF or an SBS exchange by each participant of a SB SEF or member of an SBS exchange. Proposed Rules 702(d) and (g) would require that the board of a SB SEF or SBS exchange, any executive committee of such board, and any board committee with the authority to act on behalf of the board, be composed of a majority of independent directors, and proposed Rule 702(f) would require the nominating committee of the board of the SB SEF or SBS exchange to be composed solely of independent directors. Proposed Rule 702(e) would require the board of the SB SEF or SBS exchange to establish a regulatory oversight committee consisting solely of independent directors to oversee the SB SEF's or SBS exchange's regulatory program. Any recommendation of the regulatory oversight committee not adopted by the board of the SB SEF or SBS exchange would be required to be reported promptly to the Commission. Further, proposed Rule 702(h) would require the disciplinary processes of the SB SEF or SBS exchange to provide for compositional balance and to include at least one independent director. See Regulation MC Proposing Release, 75 FR at 65904-65912.

⁷ Copies of comments received in response to the Regulation MC Proposing Release are available on the Commission's Internet website, located at <http://www.sec.gov/comments/s7-27-10/s72710.shtml>.

general solicitation of comments regarding implementation of the Dodd-Frank Act.⁸ These letters were submitted by a broad spectrum of interested parties and reflect a wide array of views regarding the proposed limitations on ownership and voting interests and governance arrangements in proposed Regulation MC.⁹ A number of commenters generally supported the Commission's efforts to address conflicts of interest at security-based swap clearing agencies, SB SEFs and SBS exchanges, and many of these commenters favored imposing more restrictive ownership and voting, or governance, requirements than were proposed in Regulation MC.¹⁰ A number of other commenters opposed some or all of the proposed restrictions and questioned whether it is necessary or appropriate for the Commission to adopt rules to mitigate conflicts of interest under Section 765 or whether the Commission should adopt rules without conducting a further review.¹¹

⁸ Comments were solicited by the Commission at <http://www.sec.gov/spotlight/dodd-frank/clearing-settlement.shtml>. Comments in response to the Commission's general solicitation are available at <http://www.sec.gov/comments/df-title-vii/mandatory-clearing/mandatory-clearing.shtml>. There is no expiration to the comment period for the Commission's general solicitation.

⁹ The commenters included individual investors, end-users, members of Congress, the U.S. Department of Justice, state legislators, labor organizations, potential security-based swap dealers and clearing agencies, and potential SBS exchanges or SB SEFs. *See supra* notes 7 and 8.

¹⁰ *See, e.g.*, Letter from U.S. Congressman Stephen F. Lynch, 9th District, Massachusetts (October 18, 2010); Letter from Americans for Financial Reform (November 16, 2010); Letter from Karrie McMillan, General Counsel, Investment Company Institute (November 17, 2010); Letter from Mike Hisler, Co-Founder, The Swaps & Derivatives Market Association (November 26, 2010); and Letter from Christine A. Varney, Assistant Attorney General, U.S. Department of Justice, Antitrust Division (December 28, 2010).

¹¹ *See, e.g.*, Letters from Roger Liddell, Chief Executive, LCH.Clearnet Group Limited (September 24, 2010 and November 5, 2010); Letter from R. Glenn Hubbard, Co-Chair, John L. Thornton, Co-Chair, and Hal S. Scott, Director, Committee on Capital Markets Regulation (November 15, 2010); Letter from James Hill, Managing Director, Morgan Stanley (November 17, 2010); Letters from Kathleen M. Cronin, Managing Director, General Counsel and Corporate Secretary, CME Group Inc. (November 17, 2010 and

On February 2, 2011, the Commission proposed an interpretation of the definition of “security-based swap execution facility,” as well as rules relating to the registration and regulation of SB SEFs.¹² The SB SEF Proposing Release includes proposals that are designed, in part, to address conflicts of interest affecting SB SEFs.¹³ The SB SEF Proposing Release seeks commenters’ views regarding the interaction of proposed Regulation SB SEF with proposed Regulation MC. Specifically, the SB SEF Proposing Release asks commenters, taking into account both proposals, to address whether the proposals contained in proposed Regulation SB SEF would appropriately address conflicts of interest concerns for SB SEFs or whether they should be revised either as unnecessary or insufficient to address such conflicts of interest. The SB SEF Proposing Release also asks commenters to provide their views on whether there any

November 24, 2010); and Letter from Robert Pickel, Executive Vice Chairman, International Swaps and Derivatives Association, Inc. (November 23, 2010).

¹² Securities Exchange Act Release No. 63825 (February 2, 2011), 76 FR 10948 (February 28, 2011) (“SB SEF Proposing Release”).

¹³ Specifically, proposed Rule 809 of proposed Regulation SB SEF would require a SB SEF to permit any security-based swap dealer, major security-based swap participant or broker to become a participant of the SB SEF as long as specified objective criteria are met; proposed Rule 811(b) would require a SB SEF to establish fair, objective, and not unreasonably discriminatory standards for granting impartial access to trading on the facility, and would specify that a SB SEF may not unreasonably prohibit or limit any person with respect to access to the services offered by the SB SEF by applying those standards in an unfair or unreasonably discriminatory manner; proposed Rule 811(b) also would require information on any grants, denials or limitations of access by the SB SEF to be reported on Form SB SEF (the proposed registration form for SB SEFs) and in the required annual report of the SB SEF’s Chief Compliance Officer; proposed Rule 811(c) would require a SB SEF to establish a compositionally balanced swap review committee to determine the security-based swaps that would trade on the SB SEF, as well as the security-based swaps that should no longer trade on the SB SEF; with respect to the determination regarding whether a particular security-based swap is “made available to trade,” that determination would be made pursuant to objective standards to be established by the Commission; and proposed Rule 820 would require that no less than 20% of the total number of directors on the SB SEF’s board be representative of SB SEF participants, and that at least one director on the SB SEF’s board be representative of investors. See SB SEF Proposing Release, supra note 12.

redundancies or gaps for mitigating conflicts of interest for SB SEFs that should be addressed.¹⁴
The public comment period for proposed Regulation SB SEF expires on April 4, 2011.

On March 2, 2011, the Commission proposed rules regarding registration of clearing agencies and standards for the operation and governance of clearing agencies¹⁵ in accordance with Sections 763 and 805 of the Dodd-Frank Act¹⁶ and Section 17A of the Exchange Act.¹⁷ Some of those proposed rules are designed, in part, to address conflicts of interest affecting clearing agencies, including security-based swap clearing agencies.¹⁸ In particular, the Clearing Agency Proposing Release includes proposed rules that would require all clearing agencies to have policies and procedures to identify and address existing or potential conflicts of interest and to establish minimum governance standards for board or board committee members.¹⁹ In addition, the Clearing Agency Proposing Release includes proposed rules that would require clearing agencies to provide opportunity for membership access to persons that are not dealers or security-based swap dealers and persons that have net capital of at least \$50 million, while also prohibiting the use of minimum portfolio size and minimum volume transaction thresholds as a

¹⁴ See SB SEF Proposing Release, supra note 12, 76 FR at 10986.

¹⁵ Securities Exchange Act Release No. 64017 (March 2, 2011) (“Clearing Agency Proposing Release”).

¹⁶ Pub. L. No. 111-203, Sections 763 and 805.

¹⁷ 15 U.S.C. 78q-1.

¹⁸ Specifically, proposed Rule 17Ad-25 under the Exchange Act would require that clearing agencies have policies and procedures to identify and address existing or potential conflicts of interest and to establish minimum governance standards for board or board committee members. Proposed Rules 17Ad-22(c)(5) and (c)(7) under the Exchange Act would require clearing agencies to provide an opportunity for membership access to persons who are not dealers or security-based swap dealers and persons who have net capital of at least \$50 million. In addition, Proposed Rule 17Ad-22(c)(6) under the Exchange Act would prohibit the use of minimum portfolio size and minimum volume transaction thresholds as a condition for membership. See Clearing Agency Proposing Release, supra note 15.

¹⁹ See Clearing Agency Proposing Release, supra note 15.

condition for membership, in order to decrease the potential for formal membership requirements to be applied anti-competitively.²⁰ The Clearing Agency Proposing Release seeks commenters' views regarding the interaction between proposed Regulation MC and the mitigation of conflicts provisions reflected in the Clearing Agency Proposing Release. The public comment period for the Clearing Agency Proposing Release closes on April 29, 2011.

When the Commission issued the SB SEF Proposing Release and Clearing Agency Proposing Release, it was mindful of its prior proposals under Regulation MC.²¹ However, the Commission recognizes that commenters who provided their views and suggestions on proposed Regulation MC did not have the benefit of considering the proposals in the SB SEF Proposing Release and the Clearing Agency Proposing Release, which also seek to address some potential conflicts of interest affecting these entities, when they submitted their comments.

The Commission therefore is reopening the comment period to invite further comment on proposed Regulation MC, particularly in light of the additional proposals relating to mitigation of conflicts for security-based swap clearing agencies and SB SEFs that are contained in the Clearing Agency Proposing Release and SB SEF Proposing Release, respectively.

II. Request for Comment

Commenters are asked to consider the provisions designed to address conflicts of interest in the Regulation MC Proposing Release and in the Clearing Agency Proposing Release and the SB SEF Proposing Release, in the aggregate, when providing further comment on how the Commission should address potential conflicts of interest at security-based swap clearing

²⁰ See Clearing Agency Proposing Release, supra note 15.

²¹ See SB SEF Proposing Release, supra note 12, at notes 82, 97, 127, 128, 134, 139, 141, 147, 172, 208, 269 and 570 and accompanying text, and 76 FR at 10979 and 10983-10986. See also Clearing Agency Proposing Release, supra note 15, at notes 45 and 107 and accompanying text.

agencies and SB SEFS, respectively. Are some or all of the proposed requirements in the SB SEF Proposing Release and the Clearing Agency Proposing Release and the requirements in the Regulation MC Proposing Release mutually supportive? Why or why not? Should any of the proposed requirements discussed in the SB SEF Proposing Release, the Clearing Agency Proposing Release, or the Regulation MC Proposing Release relating to conflicts of interest be revised in light of the proposed requirements relating to conflicts of interests in the other releases? If so, which requirements should be revised and how? Are the proposed requirements discussed in the SB SEF Proposing Release, the Clearing Agency Proposing Release, or the Regulation MC Proposing Release relating to conflicts of interest, when considered together, sufficient to mitigate conflicts of interest for SB SEFs, SBS exchanges or security-based swap clearing agencies, or should the Commission consider additional, or alternative, measures? Are any of the proposed requirements discussed in the SB SEF Proposing Release, the Clearing Agency Proposing Release, or the Regulation MC Proposing Release relating to conflicts of interest unnecessary in light of proposed requirements relating to conflicts of interest in the other releases? Why or why not?

Comments may provide the Commission with further insights regarding what mechanisms, if any, may be necessary or appropriate to mitigate conflicts of interest and how the

proposed requirements in the three proposals should be evaluated. Commenters should provide specific reasons and information to support their views and recommendations, including an analysis of why a recommendation would satisfy the statutory mandate contained in Section 765 of the Dodd-Frank Act regarding mitigation of conflicts of interest. The Commission asks that commenters, when possible, provide the Commission with empirical data to support their views.

By the Commission.

Elizabeth M. Murphy
Secretary

Date: March 3, 2011