

**COMMODITY FUTURES TRADING COMMISSION**

**17 CFR Part 23**

**RIN 3038-AC96**

**Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers  
and Major Swap Participants**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Commodity Futures Trading Commission (Commission or CFTC) is proposing rules to implement new statutory provisions enacted by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The proposed regulations establish conflicts of interest requirements for swap dealers (SDs) and major swap participants (MSPs) for the purpose of ensuring that such persons implement adequate policies and procedures in compliance with the Commodity Exchange Act (CEA), as amended by the Dodd-Frank Act.

**DATES:** Comments must be received on or before [INSERT 60 DAYS AFTER THE DATE OF PUBLICATION].

**ADDRESSES:** You may submit comments, identified by RIN number 3038-AC96 and SD-MSP Conflicts of Interest, by any of the following methods:

- Agency web site, via its Comments Online process at <http://comments.cftc.gov>.

Follow the instructions for submitting comments through the web site.

- Mail: David A. Stawick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.
- Hand Delivery/Courier: Same as mail above.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to [www.cftc.gov](http://www.cftc.gov). You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in CFTC Regulation 145.9, 17 CFR 145.9.

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from [www.cftc.gov](http://www.cftc.gov) that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

**FOR FURTHER INFORMATION CONTACT:**

Sarah E. Josephson, Associate Director, Division of Clearing and Intermediary Oversight, (202) 418-5684, [sjosephson@cftc.gov](mailto:sjosephson@cftc.gov), or Ward P. Griffin, Counsel, Office of General Counsel, (202) 418-5425, [wgriffin@cftc.gov](mailto:wgriffin@cftc.gov), Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

## **SUPPLEMENTARY INFORMATION:**

### **I. BACKGROUND**

On July 21, 2010, President Obama signed the Dodd-Frank Act.<sup>1</sup> Title VII of the Dodd-Frank Act<sup>2</sup> amended the CEA<sup>3</sup> to establish a comprehensive regulatory framework to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: (1) providing for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposing clearing and trade execution requirements on standardized derivative products; (3) creating rigorous recordkeeping and real-time reporting regimes; and (4) enhancing the rulemaking and enforcement authorities of the Commission with respect to all registered entities and intermediaries subject to the Commission's oversight.

This proposed rulemaking relates to the conflicts of interest provisions set forth in section 731 of the Dodd-Frank Act. Section 731 of the Dodd-Frank Act, in relevant part, adds a new section 4s(j)(5) to the CEA to direct each SD and MSP to implement conflicts of interest systems and procedures that establish safeguards within the firm to ensure that any persons researching or analyzing the price or market for any commodity or swap are

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<sup>1</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act may be accessed at <http://www.cftc.gov>.

<sup>2</sup> Pursuant to section 701 of the Dodd-Frank Act, Title VII may be cited as the "Wall Street Transparency and Accountability Act of 2010."

<sup>3</sup> 7 U.S.C. 1 et seq.

separated by “appropriate informational partitions” within the firm from review, pressure, or oversight of persons whose involvement in pricing, trading or clearing activities might potentially bias the judgment or supervision of the persons. Section 731 also requires additional partitions between persons “acting in a role of providing clearing activities or making determinations as to accepting clearing customers” from persons involved in pricing, trading or clearing activities. Section 731 emphasizes that pricing, trading and clearing activities should comply with open access and business conduct standards set forth elsewhere in the Act, and mandates that the required conflicts of interest systems and procedures “address such other issues as the Commission determines to be appropriate.”

Section 754 of the Dodd-Frank Act establishes that “[u]nless otherwise provided in this title, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle.” Consequently, the Commission will seek to promulgate rules—by July 15, 2011—implementing the conflicts of interest provisions of section 731 of the Dodd-Frank Act.

Accordingly, pursuant to authority granted under sections 4s(h)(1)(D), 4s(h)(3)(D), 4s(j)(7), and 8a(5) of the CEA, as amended by the Dodd-Frank Act, the Commission is proposing to adopt Rule 23.605 to address potential conflicts of interest in the preparation and release of research reports by SDs and MSPs; the establishment of “appropriate informational partitions” within such firms; and potential conflicts of interest that may arise concerning whether to accept customers for clearing. The

proposed rule also will address other issues, such as enhanced disclosure requirements, in order to minimize the potential that conflicts of interest will arise within SDs and MSPs.

The proposed rules reflect consultation with staff of the following agencies: (i) the Securities and Exchange Commission; (ii) the Board of Governors of the Federal Reserve System; (iii) the Office of the Comptroller of the Currency; and (iv) the Federal Deposit Insurance Corporation. Staff from each of these agencies has had the opportunity to provide oral and/or written comments to the proposal, and the proposed rules incorporate elements of the comments provided.

The Commission requests comment on all aspects of the proposed rules, as well as comment on the specific provisions and issues highlighted in the discussion below.

## **II. PROPOSED REGULATIONS**

### **A. Conflicts of Interest in Research or Analysis**

Section 731 of the Dodd-Frank Act requires, in relevant part, that SDs and MSPs “establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any commodity or swap . . . are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision.”

Much of the relevant language in section 731 of the Dodd-Frank Act is similar to certain language contained in section 501(a) of the Sarbanes-Oxley Act of 2002,<sup>4</sup> which amended the Securities Exchange Act of 1934 by creating a new section 15D. In relevant part, section 15D(a) mandates that the Securities and Exchange Commission, or a registered securities association or national securities exchange, adopt “rules reasonably

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<sup>4</sup> Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified at 15 U.S.C. 78o-6).

designed to address conflicts of interest that can arise when securities analysts recommend equity securities in research reports and public appearances, in order to improve the objectivity of research and provide investors with more useful and reliable information, including rules designed . . . to establish structural and institutional safeguards within registered brokers or dealers to assure that securities analysts are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision . . . .”

Unlike section 15D of the Securities Exchange Act of 1934, section 731 of the Dodd-Frank Act does not expressly limit the requirement for informational partitions to only those persons who are responsible for the preparation of the substance of research reports; rather, section 731 could be read to require informational partitions between persons involved in pricing, trading or clearing activities and any person within a SD or MSP who engages in “research or analysis of the price or market for any commodity or swap,” whether or not such research or analysis is to be made part of a research report that may be publicly disseminated.

However, the Commission believes that an untenable outcome could result from implementing informational partitions between persons involved in pricing, trading or clearing activities and all persons who may be engaged in “research or analysis of the price or market for any commodity or swap,” given that persons involved in pricing, trading or clearing activities are routinely—or even primarily—engaged in “research or analysis of the price or market for” commodities or swaps. Sound pricing, trading and/or

clearing activities necessarily require some form of pre-decisional research or analysis of the facts supporting such determinations.

Therefore, given the untenable alternative, the proposed rules reflect the Commission's belief that the Congressional intent underlying section 731 with respect to "research and analysis of the price or market of any commodity or swap" is primarily intended to prevent undue influence by persons involved in pricing, trading or clearing activities over the substance of research reports that may be publicly disseminated, and to prevent pre-public dissemination of any material information in the possession of a person engaged in research and analysis, or of the research reports, to traders.

Many elements of the proposed rule, particularly those provisions relating to potential conflicts of interest surrounding research and analysis, have been adapted from National Association of Securities Dealers (NASD) Rule 2711. To construct the "structural and institutional safeguards" mandated by Congress under section 731 of the Dodd-Frank Act, the proposed rule establishes specific restrictions on the interaction and communications between persons within a SD or MSP involved in research or analysis of the price or market for any derivative and persons involved in pricing, trading or clearing activities. The proposed rules also impose duties and constraints on persons involved in the research or analysis of the price or market for any derivative.<sup>5</sup> For instance, such persons will be required to disclose conspicuously during public appearances any relevant personal financial interests relating to any derivative of a type that the person follows. SDs and MSPs similarly will be obligated to make certain disclosures clearly and prominently in research reports, including third-party research reports that are

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<sup>5</sup> Use of the term "derivative" is based upon the products listed in the definitions of futures commission merchant and introducing broker in sections 1a(28) and 1a(29) of the CEA.

distributed or made available by the SD or MSP. Further, SDs and MSPs, as well as employees involved in pricing, trading or clearing activities, will be prohibited from retaliating against any person involved in the research or analysis of the price or market for any derivative who produces, in good faith, a research report that adversely impacts the current or prospective pricing, trading or clearing activities of the SD or MSP.

To address the possibility that the proposed rules could be evaded by employing research analysts in an affiliate of a SD or MSP, the proposed rules also will restrict communications with research analysts employed by an affiliate. An affiliate will be defined as an entity controlling, controlled by, or under common control with, a SD or MSP. Moreover, the exceptions to the definition of “research report” are designed to address issues typically found in smaller firms where individuals in the trading unit perform their own research to advise their clients or potential clients. These exceptions do not in any way impact or lessen the restrictions placed on firms that prepare research reports and release them for public consumption. Any attempt by such firms to move research personnel into a trading unit to attempt to avail themselves of the exception will result in insufficient “structural and institutional safeguards” and will be a violation of Section 731 of the Dodd-Frank Act and these Regulations.

#### B. Conflicts of Interest of Swap Dealers and Major Swap Participants in Clearing Activities

Section 4s(j)(5), as established by section 731 of the Dodd-Frank Act, requires SDs and MSPs to implement conflicts of interest systems and procedures that “establish structural and institutional safeguards to ensure that the activities of any person within the firm . . . acting in a role of providing clearing activities or making determinations as to

accepting clearing customers are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards described in this Act.”

The Commission interprets the conflicts of interest provision under section 4s(j)(5) to require informational partitions between (1) persons making clearing determinations and (2) persons involved in pricing and trading swaps (i.e., risk-taking units). This interpretation would protect against potential bias or interference in relation to “providing clearing activities.” The provision of clearing activities includes, but is not limited to, acts relating to (i) whether to offer clearing services and activities to customers; (ii) whether to accept a particular customer for the purposes of clearing derivatives; (iii) whether to submit a transaction to a particular derivatives clearing organization; (iv) setting risk tolerance levels for particular customers; (v) determining acceptable forms of collateral from particular customers; or (vi) setting fees for clearing services. However, the proposed rules are not intended to hinder the execution of sound risk management programs by SDs or MSPs, or by any affiliate of a SD or MSP.

To prevent anti-competitive discrimination in providing access to central clearing, the Commission proposes rules that will subject SDs and MSPs to restrictions that prevent risk-taking units from interfering with decisions by any affiliated clearing member of a derivatives clearing organization regarding whether to accept a client for clearing services. Under the proposed restrictions, all such decisions regarding the acceptance of customers for clearing should be made in accordance with publicly

disclosed, objective, written criteria. Risk-taking units (i.e., those persons involved in pricing and trading swaps) would also be prevented from interfering with the provision of clearing activities.

An affiliate will be defined as an entity controlling, controlled by, or under common control with, a SD or MSP. Under the term “affiliate,” in any situation where a person is dually registered as a SD or MSP, and as a futures commission merchant (FCM), the restrictions on clearing activities set forth in the proposed regulations are intended to apply to the relationship between the business trading unit of the SD or MSP and the clearing unit of the FCM, even though the business trading unit and clearing unit reside within the same entity.

### C. Other Issues

In addition to mandating the establishment of “appropriate informational partitions” within SDs and MSPs that focus on the activities of persons involved in the “research or analysis of the price or market for any commodity or swap,” section 731 of the Dodd-Frank Act also requires SDs and MSPs to “implement conflict-of-interest systems and procedures that . . . address such other issues as the Commission determines to be appropriate.” Having considered the potential conflicts of interest that may arise in a SD or MSP, the Commission is proposing rules that will address the potential for undue influence on customers. The intended cumulative effect of the proposed rules is to fulfill Congress’s objective that SDs and MSPs construct “structural and institutional safeguards” to minimize the potential conflicts of interest that could arise within such firms.

The Commission recognizes the potential development of a complex web of incentives and relationships surrounding SDs and MSPs, particularly with respect to such questions as: (1) whether to enter into a cleared or uncleared trade, (2) whether to refer a counterparty to a particular futures commission merchant for clearing, or (3) whether to send a cleared trade to a particular derivatives clearing organization. To address this issue, the Commission is proposing to require that each SD and MSP implement policies and procedures mandating the disclosure to its customers of any material incentives or any material conflicts of interest it has that relate to a customer's decision on the execution or clearing of a transaction. Such disclosures will enable customers to make fully-informed business decisions, thereby minimizing the potential influence of any incentives or conflicts of SDs and MSPs.

### **III. RELATED MATTERS**

#### **A. Regulatory Flexibility Act**

The Regulatory Flexibility Act (RFA)<sup>6</sup> requires that agencies, in proposing rules, consider the impact of those rules on small businesses. The Commission previously has established certain definitions of "small entities" to be used by the Commission in evaluating the impact of its rules on such entities in accordance with the RFA.<sup>7</sup> The proposed rules would affect SDs and MSPs.

SDs and MSPs are new categories of Commission registrants. Accordingly, the Commission has not addressed previously the question of whether such persons are, in fact, small entities for the purposes of the RFA. However, the Commission previously has determined that futures commission merchants, an existing category of registrants,

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<sup>6</sup> 5 U.S.C. 601-611.

<sup>7</sup> 47 FR 18618, Apr. 30, 1982.

are not small entities for the purposes of the RFA. The Commission's determination was based, in part, upon the obligation of futures commission merchants to meet minimum financial requirements established by the Commission to enhance the protection of customers' segregated funds and protect the financial condition of FCMs generally.<sup>8</sup> Like FCMs, SDs will be subject to minimum capital and margin requirements. SDs are expected to comprise the largest global financial firms, and the Commission is required to exempt from designation entities that engage in a de minimis level of swaps dealing in connection with transactions with or on behalf of customers. Accordingly, for purposes of the RFA for this rulemaking, the Commission is hereby proposing that SDs not be considered small entities for essentially the same reasons that FCMs previously have been determined not to be small entities and in light of the exemption from the definition of SD for those engaging in a de minimis level of swap dealing. The Commission anticipates that this exemption would tend to exclude small entities from registration.

The Commission also has previously determined that large traders are not small entities for RFA purposes.<sup>9</sup> In that determination, the Commission considered that a large trading position was indicative of the size of the business. MSPs, by statutory definition, maintain substantial positions in swaps or maintain outstanding swap positions that create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets. Accordingly, for purposes of the RFA for this rulemaking, the Commission is hereby proposing that MSPs not be considered small entities for the same reasons that large traders have previously been determined not to be small entities.

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<sup>8</sup> Id. at 18619.

<sup>9</sup> Id. at 18620.

The Commission is carrying out Congressional mandates by proposing this regulation. Specifically, the Commission is proposing these rules to comply with the Dodd-Frank Act, the aim of which is to reduce the systemic risks presented by SDs and MSPs through comprehensive regulation. The Commission does not believe that there are regulatory alternatives to those being proposed that would be consistent with the statutory mandate. Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that these proposed rules will not have a significant economic impact on a substantial number of small entities.

#### B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA)<sup>10</sup> imposes certain requirements on Federal agencies in connection with their conducting or sponsoring any collection of information as defined by the PRA. Certain provisions of this proposed rulemaking would result in new collection of information requirements within the meaning of the PRA. The Commission therefore is submitting this proposal to the Office of Management and Budget (OMB) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for this collection of information is “Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants.” The OMB has not yet assigned this collection a control number. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

The collection of information under these proposed rules is necessary to implement certain provisions of the CEA, as amended by the Dodd-Frank Act. Specifically, it is essential to ensuring that SDs and MSPs develop and maintain the

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<sup>10</sup> 44 U.S.C. 3501 et seq.

required conflicts of interest systems and procedures. The Commission’s staff would use the information collected when conducting examination and oversight to evaluate the completeness and effectiveness of the conflicts of interest procedures and disclosures of SDs and MSPs.

If the proposed regulations are adopted, responses to this new collection of information would be mandatory. The Commission will protect proprietary information according to the Freedom of Information Act and 17 CFR part 145, “Commission Records and Information.” In addition, section 8(a)(1) of the CEA strictly prohibits the Commission, unless specifically authorized by the CEA, from making public “data and information that would separately disclose the business transactions or market positions of any person and trade secrets or names of customers.” The Commission also is required to protect certain information contained in a government system of records according to the Privacy Act of 1974.<sup>11</sup>

#### 1. Information Provided by Reporting Entities/ Persons

The proposed rules will require SDs and MSPs to adopt conflicts of interest policies and procedures that may impose PRA burdens, particularly through the implementation of certain recordkeeping requirements. For purposes of the PRA, the term “burden” means the “time, effort, or financial resources expended by persons to generate, maintain, or provide information to or for a Federal agency.”<sup>12</sup> This burden will result from the recordkeeping obligations related to a SD and MSP’s obligations to adopt and implement written policies and procedures reasonably designed to ensure compliance with the proposed regulation, document certain communications between

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<sup>11</sup> 5 U.S.C. 552a.

<sup>12</sup> 44 U.S.C. 3502(2).

non-research personnel and research department personnel, record the basis upon which a research analyst's compensation was determined, and provide certain disclosures. The burden relates solely to recordkeeping requirements; the proposed regulation does not contain any reporting requirements.

The burden for compliance per respondent is expected to be 44.5 hours and \$4,450. This estimate includes the time needed to review applicable laws and regulations; develop and update conflicts of interest policies and procedures and to maintain records of certain communications and disclosures periodically required by the proposed regulation. The Commission does not expect respondents to incur any start-up costs in connection with this proposed regulation as it anticipates that respondents already maintain personnel and systems for regulatory recordkeeping.

It is not currently known how many SDs and MSPs will become subject to these rules, and this will not be known to the Commission until registration requirements for these entities become effective after July 16, 2011, the date on which the Dodd-Frank Act becomes effective. While the Commission believes that there may likely be approximately 200 SDs and 50 MSPs, it has taken a conservative approach, for PRA purposes, in estimating that there will be a combined number of 300 SDs and MSPs who will be required to establish and implement conflicts of interest policies and procedures under the proposed rules. The Commission estimated the number of affected entities based on industry data.

According to the Bureau of Labor Statistics, the mean hourly wage of an employee under occupation code 13-1041, "Compliance Officers, Except Agriculture, Construction, Health and Safety, and Transportation," that is employed by the "Securities

and Commodity Contracts Intermediation and Brokerage” industry is \$38.77.<sup>13</sup> Because SDs and MSPs include large financial institutions whose compliance employees’ salaries may exceed the mean wage, the Commission has estimated the cost burden of these proposed regulations based upon an average salary of \$100 per hour. Accordingly, the estimated burden was calculated as follows:

Recordkeeping Related to Maintenance of Conflicts of Interest Policies and Procedures

Number of registrants: 300

Average number of annual responses by each registrant: 1

Estimated average hours per response: 2

Frequency of collection: Annually

Aggregate annual burden: 300 registrants x 1 response x 2 hours = 600 burden hours

Recordkeeping Related to Communications Between Certain Personnel

Number of registrants: 300

Average number of annual responses by each registrant: 20

Estimated average hours per response: 0.5

Frequency of collection: As needed

Aggregate annual burden: 300 registrants x 20 responses x 0.5 hours = 3,000 burden hours

Recordkeeping Related to Disclosure Requirements

Number of registrants: 300

Average number of annual responses by each registrant: 65

Estimated average hours per response: 0.5

Frequency of collection: As needed

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<sup>13</sup> <http://www.bls.gov/oes/current/oes131041.htm>.

Aggregate annual burden: 300 registrants x 65 responses x 0.5 hours = 9,750 burden hours

Based upon the above, the aggregate cost for all registrants is 13,350 burden hours and \$1,335,000 [13,350 burden hours x \$100 per hour].

## 2. Information Collection Comments

The Commission invites the public and other federal agencies to comment on any aspect of the recordkeeping burdens discussed above. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Comments may be submitted directly to the Office of Information and Regulatory Affairs, by fax at (202) 395-6566 or by e-mail at [OIRAsubmissions@omb.eop.gov](mailto:OIRAsubmissions@omb.eop.gov). Please provide the Commission with a copy of submitted comments so that all comments can be summarized and addressed in the final rule preamble. Refer to the Addresses section of this notice of proposed rulemaking for comment submission instructions to the Commission. A copy of the supporting statements for the collections of information discussed above may be obtained by visiting [www.RegInfo.gov](http://www.RegInfo.gov). OMB is required to make a decision concerning the collection of

information between 30 and 60 days after publication of this document in the Federal Register. Consequently, a comment to OMB is most assured of being fully effective if received by OMB (and the Commission) within 30 days after publication.

### C. Cost-Benefit Analysis

Section 15(a) of the CEA<sup>14</sup> requires the Commission to consider the costs and benefits of its actions before issuing a rulemaking under the Act. By its terms, section 15(a) does not require the Commission to quantify the costs and benefits of the rule or to determine whether the benefits of the rulemaking outweigh its costs; rather, it requires that the Commission “consider” the costs and benefits of its actions.

Section 15(a) further specifies that the costs and benefits of a proposed rulemaking shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may, in its discretion, give greater weight to any one of the five enumerated areas and could, in its discretion, determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or accomplish any of the purposes of the Act.

#### 1. Summary of proposed requirements.

The proposed regulations would implement certain provisions of section 731 of the Dodd-Frank Act, which adds a new section 4s(j)(5) to the CEA<sup>15</sup> to direct each SD and MSP to implement conflicts of interest systems and procedures that establish

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<sup>14</sup> 7 U.S.C. 19(a).

<sup>15</sup> To be codified at 7 U.S.C. 6s(j)(5).

safeguards within the firm to ensure that any persons researching or analyzing the price or market for any commodity or swap, and any persons acting in a role of providing clearing activities or making determinations as to accepting clearing customers, are separated by “appropriate informational partitions” within the firm from review, pressure, or oversight of persons whose involvement in pricing, trading or clearing activities might potentially bias the judgment or supervision of the persons. Such conflicts of interest systems and procedures also must address any other issues that the Commission determines to be appropriate.

## 2. Costs.

With respect to costs, the Commission has determined that costs to SDs and MSPs would be minimal because the anticipated implementation of the proposed rules would require little additional resources beyond internal organizational changes to prevent compliance violations.

## 3. Benefits.

With respect to benefits, the Commission has determined that formal conflicts of interest rules will enhance transparency, bolster confidence in markets, reduce risk and allow regulators to better monitor and manage risks to our financial system.

## 4. Public Comment.

The Commission invites public comment on its cost-benefit considerations. Commenters also are invited to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the proposed regulations with their comment letters.

## **List of Subjects**

17 CFR Part 23

Antitrust, Brokers, Commodity futures, Conduct standards, Conflicts of interest, Major swap participants, Reporting and recordkeeping requirements, Swap dealers, Swaps.

For the reasons stated in this release, the Commission proposes to amend 17 CFR part 23 as follows:

**PART 23—SWAP DEALERS AND MAJOR SWAP PARTICIPANTS**

1. The authority citation for part 23 is added in its entirety as follows:

**Authority:** 7 U.S.C. 1a, 2, 6, 6a, 6b, 6b-1, 6c, 6p, 6r, 6s, 6t, 9, 9a, 12, 12a, 13b, 13c, 16a, 18, 19, 21.

2. Section 23.605 is added in its entirety as follows:

**§ 23.605 Implementation of conflicts of interest policies and procedures**

(a) Definitions. For purposes of this section, the following terms shall be defined as provided.

(1) Affiliate. This term means, with respect to any person, a person controlling, controlled by, or under common control with, such person.

(2) Business trading unit. This term means any department, division, group, or personnel of a swap dealer or major swap participant or any of its affiliates, whether or not identified as such, that performs or is involved in any pricing, trading, sales, marketing, advertising, solicitation, structuring, or brokerage activities on behalf of a swap dealer or major swap participant.

(3) Clearing unit. This term means any department, division, group, or personnel of a swap dealer or major swap participant or any of its affiliates, whether or not identified as such, that performs or is involved in any proprietary or customer clearing activities on

behalf of a swap dealer or major swap participant.

(4) Derivative. This term means (i) a contract for the purchase or sale of a commodity for future delivery; (ii) a security futures product; (iii) a swap; (iv) any agreement, contract, or transaction described in section 2(c)(2)(C)(i) or section 2(c)(2)(D)(i) of the Act; (v) any commodity option authorized under section 4c of the Act; and (vi) any leverage transaction authorized under section 19 of the Act.

(5) Non-research personnel. This term means any employee of the business trading unit or clearing unit, or any other employee of the swap dealer or major swap participant who is not directly responsible for, or otherwise involved with, research concerning a derivative, other than legal or compliance personnel.

(6) Public appearance. This term means any participation in a conference call, seminar, forum (including an interactive electronic forum) or other public speaking activity before 15 or more persons, or interview or appearance before one or more representatives of the media, radio, television or print media, or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning a derivatives transaction. This term does not include a password-protected Webcast, conference call or similar event with 15 or more existing customers, provided that all of the event participants previously received the most current research report or other documentation that contains the required applicable disclosures, and that the research analyst appearing at the event corrects and updates during the public appearance any disclosures in the research report that are inaccurate, misleading, or no longer applicable.

(7) Research analyst. This term means the employee of a swap dealer or major swap participant who is primarily responsible for, and any employee who reports directly or

indirectly to such research analyst in connection with, preparation of the substance of a research report relating to any derivative, whether or not any such person has the job title of “research analyst.”

(8) Research department. This term means any department or division that is principally responsible for preparing the substance of a research report relating to any derivative on behalf of a swap dealer or major swap participant, including a department or division contained in an affiliate of a swap dealer or major swap participant.

(9) Research report. This term means any written communication (including electronic) that includes an analysis of the price or market for any derivative, and that provides information reasonably sufficient upon which to base a decision to enter into a derivatives transaction. This term does not include:

(i) communications distributed to fewer than 15 persons;

(ii) periodic reports or other communications prepared for investment company shareholders or commodity pool participants that discuss individual derivatives positions in the context of a fund’s past performance or the basis for previously-made discretionary decisions;

(iii) any communication generated by an employee of the business trading unit that is conveyed as a solicitation for entering into a derivatives transaction, and is conspicuously identified as such; and

(iv) internal communications that are not given to current or prospective customers.

(b) Policies and Procedures. Each swap dealer and major swap participant subject to this rule must adopt and implement written policies and procedures reasonably designed to ensure that the swap dealer or major swap participant and its employees comply with

the provisions of this rule.

(c) Research Analysts and Research Reports.

(1) Restrictions on Relationship with Research Department.

(i) Non-research personnel shall not influence the content of a research report of the swap dealer or major swap participant.

(ii) No research analyst may be subject to the supervision or control of any employee of the swap dealer's or major swap participant's business trading unit or clearing unit, and no personnel engaged in pricing, trading or clearing activities may have any influence or control over the evaluation or compensation of a research analyst.

(iii) Except as provided in paragraph (c)(1)(iv) of this section, non-research personnel, other than the board of directors and any committee thereof, shall not review or approve a research report of the swap dealer or major swap participant before its publication.

(iv) Non-research personnel may review a research report before its publication as necessary only to verify the factual accuracy of information in the research report, to provide for non-substantive editing, to format the layout or style of the research report, or to identify any potential conflicts of interest, provided that:

(A) any written communication between non-research personnel and research department personnel concerning the content of a research report must be made either through authorized legal or compliance personnel of the swap dealer or major swap participant or in a transmission copied to such personnel; and

(B) any oral communication between non-research personnel and research department personnel concerning the content of a research report must be documented and made either through authorized legal or compliance personnel acting as an intermediary or in a

conversation conducted in the presence of such personnel.

(2) Restrictions on Communications. Any written or oral communication by a research analyst to a current or prospective counterparty, or to any employee of the swap dealer or major swap participant, relating to any derivative must not omit any material fact or qualification that would cause the communication to be misleading to a reasonable person.

(3) Restrictions on Research Analyst Compensation. A swap dealer or major swap participant may not consider as a factor in reviewing or approving a research analyst's compensation his or her contributions to the swap dealer's or major swap participant's trading or clearing business. No employee of the business trading unit or clearing unit of the swap dealer or major swap participant may influence the review or approval of a research analyst's compensation.

(4) Prohibition of Promise of Favorable Research. No swap dealer or major swap participant may directly or indirectly offer favorable research, or threaten to change research, to an existing or prospective counterparty as consideration or inducement for the receipt of business or compensation.

(5) Disclosure Requirements.

(i) Ownership and Material Conflicts of Interest. A swap dealer or major swap participant must disclose in research reports and a research analyst must disclose in public appearances:

(A) whether the research analyst maintains, from time to time, a financial interest in any derivative of a type that the research analyst follows, and the general nature of the financial interest; and

(B) any other actual, material conflicts of interest of the research analyst or swap dealer or major swap participant of which the research analyst has knowledge at the time of publication of the research report or at the time of the public appearance.

(ii) Prominence of Disclosure. Disclosures and references to disclosures must be clear, comprehensive, and prominent. With respect to public appearances by research analysts, the disclosures required by paragraph (c)(5) of this section must be conspicuous.

(iii) Records of Public Appearances. Each swap dealer and major swap participant must maintain records of public appearances by research analysts sufficient to demonstrate compliance by those research analysts with the applicable disclosure requirements under paragraph (c)(5) of this section.

(iv) Third-Party Research Reports.

(A) For the purposes of paragraph (c)(5)(iv) of this section, “independent third-party research report” shall mean a research report, in respect of which the person or entity producing the report:

(1) has no affiliation or business or contractual relationship with the distributing swap dealer or major swap participant, or that swap dealer’s or major swap participant’s affiliates, that is reasonably likely to inform the content of its research reports; and

(2) makes content determinations without any input from the distributing swap dealer or major swap participant or that swap dealer’s or major swap participant’s affiliates.

(B) Subject to paragraph (c)(5)(iv)(C) of this section, if a swap dealer or major swap participant distributes or makes available any independent third-party research report, the swap dealer or major swap participant must accompany the research report with, or provide a web address that directs the recipient to, the current applicable disclosures, as

they pertain to the swap dealer or major swap participant, required by this section. Each swap dealer and major swap participant must establish written policies and procedures reasonably designed to ensure the completeness and accuracy of all applicable disclosures.

(C) The requirements of paragraph (c)(5)(iv)(B) of this section shall not apply to independent third-party research reports made available by a swap dealer or major swap participant to its customers:

(1) upon request; or

(2) through a website maintained by the swap dealer or major swap participant.

(6) Prohibition of Retaliation Against Research Analysts. No swap dealer or major swap participant, and no employee of a swap dealer or major swap participant who is involved with the swap dealer's or major swap participant's pricing, trading or clearing activities, may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the swap dealer or major swap participant or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made, in good faith, by the research analyst that may adversely affect the swap dealer's or major swap participant's present or prospective pricing, trading or clearing activities.

(d) Clearing activities.

(1) No swap dealer or major swap participant shall directly or indirectly interfere with or attempt to influence the decision of any affiliated clearing member of a derivatives clearing organization with regard to the provision of clearing services and activities, including but not limited to: (i) whether to offer clearing services and activities to

customers; (ii) whether to accept a particular customer for the purposes of clearing derivatives; (iii) whether to submit a transaction to a particular derivatives clearing organization; (iv) setting risk tolerance levels for particular customers; (v) determining acceptable forms of collateral from particular customers; or (vi) setting fees for clearing services.

(2) Each swap dealer and major swap participant shall create and maintain an appropriate informational partition, as specified in section 4s(j)(5)(A) of the Act, between business trading units of the swap dealer or major swap participant and clearing member personnel of any affiliated clearing member of a derivatives clearing organization. At a minimum, such informational partitions shall require that no employee of a business trading unit of a swap dealer or major swap participant shall supervise, control, or influence any employee of a clearing member of a derivatives clearing organization.

(e) Undue Influence on Counterparties. Each swap dealer and major swap participant must adopt and implement written policies and procedures that mandate the disclosure to its counterparties of any material incentives and any material conflicts of interest regarding the decision of a counterparty: (1) whether to execute a derivative on a swap execution facility or designated contract market, or (2) whether to clear a derivative through a derivatives clearing organization.

(f) All records that a swap dealer or major swap participant is required to maintain pursuant to this regulation shall be maintained in accordance with Commission Regulation § 1.31 and shall be made available promptly upon request to representatives of the Commission and to representatives of the applicable prudential regulator, as defined in 7 U.S.C. 1a(39).

Issued in Washington, DC, on November 10, 2010, by the Commission.

David A. Stawick,  
Secretary of the Commission.

## **Statement of Chairman Gary Gensler**

### **Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants**

I support the proposed rulemakings that establish firewalls to ensure a separation between the research arm, the trading arm and the clearing activities of swap dealers, major swap participants, futures commission merchants and introducing brokers. This rule proposal relates to the conflicts-of-interest provisions of the Dodd-Frank Act that direct swap dealers and major swap participants to have appropriate informational partitions. The proposal builds upon similar protections in the securities markets as mandated in the Sarbanes-Oxley Act. The proposed rules will protect market participants and the public while also promoting the financial integrity of the marketplace.