



Commodity Futures Trading Commission

Office of Public Affairs

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Proposed Rules Regarding Business Conduct Standards for Swap Dealers and Major Swap Participants Dealing with Counterparties

The Commodity Futures Trading Commission (Commission) is proposing rules concerning external business conduct standards for swap dealers and major swap participants dealing with counterparties.

Overview of Business Conduct Standards under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)

The Dodd-Frank Act adds Section 4s(h) to the Commodity Exchange Act (“the Act”), which provides the Commission with rulemaking authority to impose business conduct standards for swap dealers and major swap participants (SDs/MSP) dealing with counterparties generally and additional requirements for counterparties that are “Special Entities.” Special Entities include Federal agencies, States and political subdivisions, municipalities, employee benefit plans as defined under the Employee Retirement Income Security Act of 1974 (“ERISA”), governmental plans as defined under ERISA, and endowments.

The Commission’s proposed rules, outlined below, prohibit certain activities and impose duties on SDs/MSPs in their dealings with counterparties.

General provisions

- Policies and procedures to ensure compliance and prevent evasion of the Act and proposed rules
- Diligent supervision
- “Know your counterparty” and “true name and owner” of counterparty
- Record retention requirements

Prohibition on fraud, manipulation and other abusive practices

- Prohibits fraudulent, deceptive, and manipulative acts or practices
- Requires confidential treatment of counterparty information
- Prohibits trading ahead and front running of counterparty swap transactions

Duties to all counterparties

- **Verification** – Duty to verify a counterparty’s eligibility to transact in swaps markets
- **Disclosure of:**
 - Material risks
 - For high-risk complex bilateral swaps, a duty to provide scenario analyses
 - For bilateral swaps not available for trading on a designated contract market or swap execution facility, counterparty can “opt-in” to obtain scenario analyses
 - Material characteristics
 - Material incentives and conflicts of interest

- **Daily Mark** – Duty to provide the daily mid-market value of uncleared swaps to the counterparty
- **Clearing** – Duty to notify a counterparty of its right (1) to clear a swap that is exempt from mandatory clearing and (2) select the derivatives clearing organization
- **Fair Dealing and Good Faith Communications** – Duty to ensure all communications to a counterparty are fair and balanced
- **Institutional Suitability** – Duty to ensure swap recommendations are suitable for the counterparty
- **Execution Standards for all Registrants** – For swaps available for trading on a designated contract market or swap execution facility, a duty to execute orders on terms that are reasonably related to the best terms available.

Swap dealers acting as advisors to Special Entities

- Duty for any swap dealer that “acts as an advisor to a Special Entity” to act in the “best interests” of the Special Entity
- “Acts as an advisor to a Special Entity” includes recommending a swap or trading strategy involving a swap, but does not include information that is general transaction, financial or market information or swap terms provided in response to the Special Entity’s competitive bid request

Swap dealers and major swap participants acting as counterparties to Special Entities

Duty to have a reasonable basis to believe that any Special Entity counterparty has a “representative” that meets the following criteria:

- is sufficiently knowledgeable to evaluate the transaction and risks;
- is not subject to statutory disqualification;
- is independent of the swap dealer or major swap participant;
- acts in the best interests of the Special Entity;
- makes appropriate and timely disclosures to the Special Entity;
- evaluates, consistent with any guidelines provided by the Special Entity, fair pricing and appropriateness of the swap;
- in the case of a Special Entity that is an employee benefit plan subject to ERISA, is a fiduciary as defined in Section 3 of ERISA; and
- in the case of a Special Entity that is a municipal entity, is subject to restrictions on certain political contributions to certain public officials of the municipal entity, unless the representative is in house

When entering into a swap with a Special Entity, duty to disclose the capacity in which SD/MSP is acting

Political contributions by certain swap dealers and major swap participants

Two-year prohibition on entering swaps with a municipal entity when SD/MSP makes certain political contributions to certain officials of the municipal entity

Means of compliance with business conduct standards

As appropriate, SDs/MSPs can:

- reasonably rely, absent red flags, on representations of counterparties to meet due diligence obligations
- make disclosures by any reliable means agreed to by the counterparty
- make generic disclosures to counterparties in a standard format
- include representations and disclosures in a master agreement between the parties, and deem them renewed with each subsequent swap