



## The SEC's Final Rule Regarding Price Quotes and Research Reports Relating to Security-Based Swaps

This month the Securities and Exchange Commission (“SEC”) issued a final rule (the “Final Rule”)<sup>1</sup> that provides that certain communications relating to security-based swaps (either singular or plural, “SBS”) will not constitute “offers” for purposes of Section 5 of the Securities Act of 1933 (the “Securities Act”).<sup>2</sup> Section 5 generally requires that an offer or sale of a security be registered under the Securities Act or made pursuant to an exemption from registration, and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”)<sup>3</sup> defined securities for many purposes to include SBS. The Final Rule makes clear that the publication or distribution of certain price quotes relating to SBS, and of certain research reports discussing SBS, will not constitute offers of the related SBS for purposes of Section 5 and thus should not require registration. The Final Rule became effective upon its publication in the Federal Register on January 16, 2018.

While market participants will likely welcome the Final Rule, its accompanying release (the “Final Rule Release”) appears to throw cold water on the hope that the SEC will decide generally to exempt many SBS from registration. Offers and sales of SBS have historically not been subject to registration, and the SEC has instituted interim exemptions, which remain in effect, for registration and certain other requirements with respect to SBS. Accordingly, the market has generally not prepared for the potential necessity to register offerings of SBS.

Notwithstanding the issuance of the Final Rule, it appears that the SEC has effectively placed on its back burner numerous other significant rules relating to SBS that the SEC has not yet finalized. In this client alert we discuss both the Final Rule and, more broadly, the status of the SEC’s rules for SBS.

### The Final Rule

#### Publication or Distribution of Quotes

The Final Rule provides that, for purposes of Section 5, the publication or distribution of quotes relating to SBS will not constitute an offer, an offer to sell, or a solicitation of an offer to buy or purchase any SBS or any guarantee<sup>4</sup> of such SBS that is a security if the SBS:

- may be purchased only by eligible contract participants (each, an “ECP”)<sup>5</sup>; and

<sup>1</sup> Treatment of Certain Communications Involving Security-Based Swaps That May Be Purchased Only By Eligible Contract Participants, 83 Fed. Reg. 2046 (January 16, 2018), available [here](#).

<sup>2</sup> 15 U.S.C. § 77a et seq.

<sup>3</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 701–74, 124 Stat. 1376, 1641–802 (2010) (codified as amended in scattered sections of 7, 12 and 15 U.S.C. (2012)).

<sup>4</sup> The SEC notes that a guarantee of a security is itself a security for purposes of the Securities Act and that a guarantee of an SBS is part of the SBS transaction. See Final Rule Release, 83 Fed. Reg. at 2047 n. 12.

<sup>5</sup> ECPs are defined in Section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)). Section 5(e) of the Securities Act requires registration in connection with SBS involving non-ECPs, providing that, unless a registration statement meeting applicable requirements is in effect as to an SBS, it is unlawful for any person making use of interstate commerce to offer to sell, offer to buy or purchase or sell an SBS to any person who is not an ECP.

- are traded or processed on or through a trading system or platform that either is registered as a national securities exchange or as a security-based swap execution facility (an “SBSEF”) under the Securities Exchange Act of 1934 (the “Exchange Act”)<sup>6</sup> or is exempt from registration as an SBSEF under the Exchange Act.<sup>7</sup>

#### Publication or Distribution of Research Reports

In addition, the Final Rule provides that, for purposes of Section 5, a broker, dealer, or security-based swap dealer’s publication or distribution of a research report (as defined in Rule 139(d) under the Securities Act)<sup>8</sup> that discusses SBS will not constitute an offer, an offer to sell, or a solicitation of an offer to buy or purchase SBS or any guarantee of such SBS that is a security if:

- the SBS may be purchased only by ECPs;
- the broker, dealer, or security-based swap dealer publishes or distributes research reports on the issuer underlying the SBS or its securities in the regular course of its business; and
- the publication or distribution of the research report does not represent the initiation of publication of research reports about such issuer or its securities or the reinitiation of such publication following discontinuation of publication of such research reports.<sup>9</sup>

For purposes of the Final Rule, the term “issuer” means the issuer of any security or loan referenced in the SBS, each issuer of a security in a narrow-based security index referenced in the SBS, or each issuer referenced in the SBS.

The Final Rule is not intended to change the treatment of research reports relating to securities under existing Rules 137, 138 and 139 under the Securities Act. Research reports relating to the securities underlying SBS are to be analyzed under Rules 137, 138 and 139, and research reports relating to SBS are to be analyzed under the Final Rule.<sup>10</sup>

#### Purposes of the Final Rule

The Final Rule is intended to remove regulatory uncertainty with respect to publications and distributions of SBS price quotes and SBS-related research reports that could, in the absence of the Final Rule, be understood to constitute offers under Section 5 of the Securities Act. In addition, with respect to SBS price quotes, the Final Rule is intended to help to bring SBS trading onto regulated trading platforms, such as SBSEFs, and thus to increase transparency in the SBS market. With respect to research reports, the Final Rule is intended to ensure similar treatment for research reports involving SBS and those involving other securities, and to assure that market participants continue to have access to key information regarding SBS.<sup>11</sup>

#### **Prospects for a General Exemption from Registration for SBS Between ECPs**

The Final Rule Release contains language indicating that it is unlikely that, after SEC interim exemptions expire, offers or sales of SBS involving ECPs<sup>12</sup> will be generally exempt from registration.

The SEC stated that it was “not persuaded that there is a need for an exemption from the registration and other provisions of the Securities Act for security-based swap transactions between ECPs.”<sup>13</sup> Further, referring to the

<sup>6</sup> 15 U.S.C. § 78a et seq.

<sup>7</sup> Rule 230.135d(a) under the Securities Act, 83 Fed. Reg. at 2056.

<sup>8</sup> Rule 139(d) defines a research report, in part, as a written communication that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision. See Final Rule Release, 83 Fed. Reg. at 2047 n. 14.

<sup>9</sup> Rule 230.135d(b) under the Securities Act, 83 Fed. Reg. at 2056.

<sup>10</sup> Final Rule Release, 83 Fed. Reg. at 2047.

<sup>11</sup> *Id.* at 2050-52

<sup>12</sup> See footnote 5 above regarding the registration of offers of SBS involving parties that are not ECPs.

<sup>13</sup> Final Rule Release, 83 Fed. Reg. at 2049.

SEC's existing interim exemptions from registration and other requirements with respect to SBS, the SEC noted: "we are taking no action as to the interim final exemptions, and our adoption of the final rule in this release will not affect the interim final exemptions. The interim final exemptions expire on February 11, 2018."<sup>14</sup> In a footnote, however, the SEC noted the possibility that the expiration date could be extended by further action.<sup>15</sup>

Market participants should begin to consider how they may be able to use existing exemptions in connection with sales of SBS and to determine in which circumstances registration of offers or sales of SBS might prove necessary.

### **Status of the SEC's Rules for SBS**

Notwithstanding the issuance of the Final Rule, and the fact that the SEC has already proposed a large majority of the SBS rules that it has not yet finalized, it appears that a significant amount of time will likely elapse before the SEC finalizes most of its remaining SBS rules. This counterintuitive time frame is an apparent result of the SEC's delays in finalizing many of its SBS rules and its desire to consider harmonizing its already proposed rules for SBS with the corresponding rules of the Commodity Futures Trading Commission ("CFTC") for swaps.

With few exceptions, the SEC's current regulatory agenda, released in December 2017 (and available [here](#)), reflects the SEC's rules for SBS as "long-term actions," meaning that they "are items under development but for which the agency does not expect to have a regulatory action within the 12 months after publication of this edition" of the unified regulatory agenda.<sup>16</sup> Accordingly, it appears that December 2018 is the earliest time when the SEC expects to take its next regulatory action with respect to a large majority of its remaining rules for SBS, including, among others, certain rules that the SEC has stated must be finalized before the SEC will require security-based swap dealers to register with the SEC.<sup>17</sup>

The sole SBS rule that the SEC's regulatory agenda reflects as being at the proposed rule stage is a rule identified as "Harmonization of Certain Title VII Rules." Regarding this possible proposal, a link from the regulatory agenda, available [here](#), states that an SEC division "is considering recommending that the Commission propose rules to harmonize certain [Dodd-Frank Act] rules with the CFTC."

A coordinated attempt to harmonize the SEC's rules for SBS with the CFTC's rules for swaps would be in accordance with a recent report of the Department of the Treasury that recommended that the SEC and CFTC "give high priority to a joint effort to review their respective rulemakings" relating to derivatives. The report stated that the goals of that "exercise should be to harmonize rules and eliminate redundancies to the fullest extent possible and to minimize imposing distortive effects on the markets and duplicative and inconsistent compliance burdens on market participants."<sup>18</sup>

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<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 2053 note 78.

<sup>16</sup> Website of the Office of Information and Regulatory Affairs, Office of Management and Budget, explanation of "Long-Term Actions," available [here](#).

<sup>17</sup> In final rules issued in 2015, the SEC identified several rules that it would issue in final form before requiring security-based swap dealers to register with the SEC. Those rules included, among others, final rules establishing (i) capital, margin and segregation requirements for security-based swap dealers; (ii) recordkeeping and reporting requirements for security-based swap dealers; and (iii) a process for a registered security-based swap dealer to make an application to the SEC to allow an associated person subject to a statutory disqualification to effect or be involved in effecting SBS on its behalf. Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, 80 Fed. Reg. 48963, 48964 (August 14, 2015). Each of these three rules is now listed on the SEC's regulatory agenda as a "long-term action."

<sup>18</sup> U.S. Department of the Treasury, "A Financial System that Creates Economic Opportunities, Capital Markets" (October 2017), at 127.

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