



CLIENT ALERT
JULY 25, 2023

SEC Adopts Security-Based Swaps Fraud Prevention Rules

1. Introduction

On June 7, 2023, the Securities and Exchange Commission (the “SEC”) adopted two new rules (each a “Rule” and, collectively, the “Rules”) designed to prevent: (1) fraud, manipulation and deception in connection with security-based swap transactions (the “SBS Anti-Fraud Rule”), and (2) undue influence over the chief compliance officer (“CCO”) of any security-based swap dealer or major security-based swap participant (each, an “SBS Market Participant” and, such Rule, the “CCO Independence Rule”).¹

2. The SBS Anti-Fraud Rule

The SBS Anti-Fraud Rule establishes grounds for liability, specific to security-based swaps, that will apply in addition to those existing under generally applicable anti-fraud securities laws. The Rule is intended to cover the lifecycle of the security-based swap and will potentially have far-reaching impacts on how SBS entities conduct their activities.

More specifically, the Rule makes it unlawful for any person, to, directly or indirectly: (i) effect (or attempt to effect), any transaction in any security-based swap; (ii) purchase, sell, or induce (or attempt to induce the purchase or sale of) any security-based swap (including but not limited to, in whole or in part, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of any rights or obligations under, a security-based swap, as the context may require), in connection with which such person:

- (1) Employs or attempts to employ any device, scheme, or artifice to defraud or manipulate;
- (2) Makes or attempts to make any untrue statement of a material fact, or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading;
- (3) Obtains money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading;

¹ [Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers](#), Release No. 34-97656, (June 7, 2023) (to be codified at 17 C.F.R. Part 240).

- (4) Engages in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person;
- (5) Attempts to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or attempts to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person; or
- (6) Manipulates or attempts to manipulate the price or valuation of any security-based swap, or any payment or delivery related thereto.

The SEC provides two affirmative defenses to SBS Market Participants that, while being aware of material nonpublic information, engaged in actions that would otherwise violate prongs (1) through (5) above:

- I. the first defense applies where an action is taken not on the basis of material nonpublic information, but in accordance with the written agreements governing the transaction (i.e., actions in the normal course of the transaction such as transfers of collateral), so long as (i) the swap was entered into, or amendment thereto made, prior to the person becoming aware of the material nonpublic information and (ii) the person acted in good faith; and
- II. the second defense, available for actions taken by entities, applies where (i) the individual making investment decisions on behalf of the entity was not aware of the material nonpublic information, and (ii) the entity had implemented reasonable policies and procedures (such as information barriers) to ensure that individuals making investment decisions would not violate prongs (1) through (5) above.

3. The CCO Independence Rule

The CCO Independence Rule makes it unlawful for any officer, director, supervised person, or employee of an SBS Market Participant or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the CCO in the performance of their duties. The scope of the Rule is deliberately broad. In the final release, the SEC clarifies that the Rule does not merely capture undue influence from actors with authority over the CCO (i.e., the power to set the compensation of, hire, or fire the CCO). Rather, "undue influence could arise from many actors (and many actions)."

4. Next Steps

The Rules become effective on August 29, 2023. With that date in mind, market participants are encouraged to review their internal compliance programs to ensure they are designed to prevent non-compliance with the Rules.

