

## Security-Based Swap Rules for End-Users

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As of November 1, 2021, dealers in security-based swaps (“SBS”) whose dealing activity exceeds certain *de minimis* thresholds (e.g., gross notional amount of \$3 billion for credit default SBS, \$150 million for other SBS, and \$25 million for SBS where the counterparty is a special entity) are required to register with the SEC as a security-based swap dealer (“SBSD”) and to comply with the SEC’s regulations applicable to SBS.<sup>[1]</sup> Many dealers exceeded these thresholds and filed for registration on or prior to November 1. Other dealers who exceed these thresholds later will be required to register at a future date.

While the SEC’s SBS regulations apply directly to the SBSD, non-dealer counterparties to SBS with a registered SBSD will need to take certain actions, including:

- For new trades entered into on or after November 1, 2021 (or a later date on which the SBSD is required to register), completing new documentation to assist the SBSD in determining whether the SBS rules will apply to such transactions and to allow the SBSD to comply with such rules;
- For existing SBS transactions entered into prior to such date, amending their trading documentation (either bilaterally or via ISDA Protocols) to comply with the SBS rules; and
- For new SBS transactions with SBSDs that are not prudentially regulated (e., non-bank SBSDs),<sup>[2]</sup> exchanging margin with respect to such transactions.

### Are my SBS transactions in scope?

SBSDs have been contacting SBS counterparties to request information to determine the extent to which the SBS rules apply and the availability of any exceptions or exemptions.

Counterparties will need to provide their SBSDs with information regarding their entity type, registration status and connection to the United States, among other details. This may be accomplished either bilaterally or on a comprehensive basis with all registered SBSD counterparties

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using ISDA's U.S. Self-Disclosure Letter<sup>[3]</sup> (including via the online 'ISDA Amend' service offered through IHS Markit).

## Updating trading documentation

On or before the date on which a dealer is first required to register as an SBSD, a counterparty to any existing SBS with such dealer will need to amend its agreements to address various aspects of the SEC's SBS regime, including (among others) business conduct standards for SBSDs, reporting of SBS information, trade acknowledgment and verification and, in certain cases (e.g., trades with other dealers or financial entities), risk mitigation techniques for uncleared SBS.

ISDA has developed two Protocols for this purpose: a comprehensive SBS Protocol and a streamlined Top-Up Protocol. Parties may also incorporate the relevant provisions on a bilateral basis.

The SBS Protocol is available to parties who have not previously adhered to the Dodd-Frank Protocols for the CFTC's swaps regime (the "CFTC DF Protocols")<sup>[4]</sup> and provides a standalone compliance method to exchange information and make certain elections via questionnaires.

The Top-Up Protocol, on the other hand, is available to parties that have already adhered to the CFTC DF Protocols. It sets out a series of amendments and additions to the provisions previously incorporated for CFTC compliance—in effect, allowing these existing terms to be "topped up" for SEC compliance, without the need to complete additional questionnaires.

For any new SBS agreements entered into following adherence, the parties will need to either incorporate the relevant Protocol by reference or otherwise provide required information and representations (e.g., KYC, institutional suitability, 'U.S. person' status) and make certain elections and agreements (e.g., clearing, risk valuation and portfolio reconciliation) to allow the SBSD to achieve compliance on a bilateral basis.

## Margin for Uncleared SBS

Once registered, non-bank SBSDs (e.g., broker-dealers) will be required to exchange variation margin with their SBS counterparties, subject to certain exceptions.<sup>[5]</sup>

In addition, beginning on September 1, 2022, such SBSDs may be required to collect initial margin from their counterparties in certain circumstances (*i.e.*, where a \$50 billion notional amount threshold is exceeded).

## FOOTNOTES

<sup>[1]</sup> Security-based swaps subject to SEC regulation include certain credit and equity swaps based on a single security or loan, a "narrow-based security index" or the occurrence of certain events relating to a single issuer or issuers of securities in a narrow-based security index (*i.e.*, CDS).

<sup>[2]</sup> The banking regulators' margin rules will continue to apply to SBS with prudentially regulated SBSDs.

<sup>[3]</sup> The ISDA U.S. Self-Disclosure Letter was published on January 15, 2021 and is available on

ISDA's website.

<sup>[4]</sup> The SBS Protocol may also be used by parties whose SBS elections will differ from their prior elections with respect to swaps under the CFTC DF Protocols.

<sup>[5]</sup> One exception applies to uncleared SBS with a counterparty that qualifies from the so-called "end-user exception" from the clearing requirement in section 3C(g)(1) of the Exchange Act, which is available where the counterparty is not a "financial entity" and uses the SBS to hedge or mitigate commercial risk.

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