

SEC Adopts Rules to Prohibit Fraud Related to Security-Based Swaps and Exertion of Undue Influence Over SBS Swap Dealer CCOs

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On June 7, 2023, the Securities and Exchange Commission (SEC) adopted two new rules to address misconduct in the security-based swaps market. The first rule prohibits fraud, manipulation and deception in connection with effecting or entering security-based swap transactions. Notably, this rule contains a specific prohibition against attempting to manipulate the prices or valuations of security-based swaps, including related payments and deliveries. See our December 20, 2021, client alert, "[SEC Revives Proposed Antifraud Rule for Security-Based Swap Transactions](#)."

The second rule prevents undue influence over the chief compliance officer (CCO) of security-based swap dealers and major security-based swap participants (SBS Entities).¹

Rule 9j-1(a): Prohibition Against Fraud, Manipulation and Deception

The first of the two new rules adopted by the SEC, Rule 9j-1(a), prohibits fraudulent, deceptive or manipulative misconduct related to security-based swap transactions.²

Specifically, Rule 9j-1(a) states:

- (a) It shall be unlawful for any person, directly or indirectly, to effect any transaction in, or attempt to effect any transaction in, any security-based swap, or to purchase or 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;
 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.³

Several provisions are particularly noteworthy:

¹ SEC Adopts Rules to Prevent Fraud in Connection with Security-Based Swaps Transactions and Prevent Undue Influence over CCOs, Press Release No. 2023-104, (June 7, 2023).

² Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers, Release No. 34-97656, at 23--24, (June 7, 2023) (to be codified at 17 C.F.R. Part 240).

³ *Id.* at 133--34.

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Negligent Conduct Is Actionable

Certain types of misconduct prohibited under the final Rule 9j-1 will only require a showing of negligence. Specifically, a finding that money or property was obtained through a material misstatement or omission under subsection (a)(3), or a finding that an act, practice or course of business operates as a fraud or deceit under subsection (a)(4) require only a showing of negligence.⁴ A finding under subsections (a)(1), (2), (5) and (6), however, will require a showing of scienter.⁵

Attempted Conduct Is Covered

The rule applies to attempted as well as completed misconduct. However, a finding of an attempted material misstatements or omissions or fraudulent acts or practices must be made under subsection (a)(5), not (a)(3) or (4), and, unlike completed conduct of that same type, would require a showing of scienter.⁶

Possession of Material Non-Public Information

By explicitly providing certain affirmative defenses, the SEC has indicated that subsections (a)(1) through (5) of Rule 9j-1 will apply to misconduct involving the possession of material nonpublic information.

The first defense is available, under Rule 9j-1(e)(1), where the action was taken pursuant to binding rights and obligations in written security-based swap documentation, so long as the security-based swap transaction occurred before the person became aware of the material nonpublic information, and the person acted in good faith.⁷

The second defense is available, under Rule 9j-1(e)(2), to entities that demonstrate that the investment decision-maker was not aware of material nonpublic information and that the entity had reasonable policies and procedures in place to prevent violations of subsections (a)(1) through (5).⁸

Price Manipulation Prohibited

The final Rule 9j-1 also includes subsection (a)(6), which prohibits the manipulation or attempted manipulation of security-based swap prices and valuations, including related payments and deliveries.⁹ A finding of liability under the price manipulation rule will require proof of scienter, but reckless as well as intentional misconduct will be sufficient for liability.¹⁰

⁴ *Id.* at 38.

⁵ *Id.*

⁶ *Id.* at 45.

⁷ *Id.* at 19.

⁸ *Id.*

⁹ *Id.* at 50.

¹⁰ *Id.* at 51.

The prohibition on price manipulation was adopted in light of the SEC's apparent view that there is incentive and opportunity for parties to engage in misconduct by triggering, avoiding or affecting the value of ongoing payments or deliveries in connection with security-based swaps.¹¹ The SEC specifically cited the following credit default swap (CDS) strategies, among others, as examples of price manipulation concerns in the security-based swap market:

- A CDS buyer working with a reference entity to trigger a payment on a CDS — to the detriment of the CDS seller — by creating an artificial, technical or temporary failure-to-pay credit event.¹²
- A CDS seller “orphans” the CDS, reducing the likelihood of a credit event, by moving the reference entity's debts to a subsidiary or an affiliate that is not referenced by the CDS.¹³

The price manipulation rule applies only to actions taken outside the ordinary course of a typical lender-borrower relationship, such as actions taken to avoid, cause, increase or decrease payments under a security-based swap, or actions designed almost exclusively to harm counterparties.¹⁴ In its guidance, the SEC provided assurance that the final rule should not discourage lenders from discussing or providing financing or relief to avoid default.¹⁵

Rule 15fh-4(c): Preventing Undue Influence over SBS Entities' CCOs

The second rule adopted by the SEC, Rule 15fh-4(c), “makes it unlawful for any officer, director, supervised person, or employee of an SBS Entity, or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the SBS Entity's CCO in the performance of their duties under the Federal securities laws or the rules and regulations thereunder.”¹⁶

The new CCO rule is aimed at protecting the independence and objectivity of CCOs by preventing coercion, misleading acts and other interference with CCOs by other SBS personnel.¹⁷ The broad rule covers, among other actions, attempts by officers, directors or other employees to hide transactions, submit false valuations or otherwise manipulate the CCO.¹⁸ Notably, liability under Rule 15fh-4(c) will not require a showing of scienter or materiality.¹⁹

¹¹ *Id.* at 15.

¹² *Id.* at 16.

¹³ *Id.* at 17.

¹⁴ *Id.* at 55.

¹⁵ *Id.* at 55–56.

¹⁶ *Id.* at 79.

¹⁷ *Id.* at 19.

¹⁸ *Id.* at 83.

¹⁹ *Id.* at 84.