



Political Law Alert

Contacts

Kenneth A. Gross

Partner
202.371.7007
kenneth.gross@skadden.com

Ki P. Hong

Partner
202.371.7017
ki.hong@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

Four Times Square
New York, NY 10036
212.735.3000

1440 New York Avenue, N.W.
Washington, D.C. 20005
202.371.7000

SEC Adopts Security-Based Swap Dealer Pay-to-Play Rule

The Securities and Exchange Commission (SEC) recently adopted Rule 15Fh-6, the pay-to-play rule for security-based swap (SBS) dealers. The rule is almost identical to the Commodity Futures Trading Commission (CFTC) pay-to-play rule for swap dealers, CFTC 23.451. The SBS rule will take effect June 27, 2016. The compliance date for this rule, along with the other SBS business conduct standards adopted at the same time, will be the date on which an SBS dealer is required to register. Please note that no SBS dealer will be required to register until a number of regulatory benchmarks have been hit. We will continue to monitor for further developments. Below is a summary of the rule.

What Type of Business Is Covered?

The rule covers security-based swaps that an SBS dealer offers or enters into with a municipal entity, which is defined as (1) a state, state agency, city, county, municipality or other political subdivision of a state; or any instrumentality, department or corporation of or established by a state or political subdivision of a state, (2) any plan, program or pool of assets sponsored or established by a state, subdivision or instrumentality, or (3) any other issuer of municipal securities.

Prohibitions on Political Contributions

Ban on Making Political Contributions. The rule prohibits an SBS dealer from offering or entering into a security-based swap or trading strategy involving a security-based swap with a municipal entity for two years following the SBS dealer or one of its covered associates (defined below and including any political action committee they control) contributing to an official of that municipal entity. This includes not only political contributions to the official's election campaign but also to his or her inaugural and transition committees.

Covered Officials. An official of a municipal entity is a candidate for, successful candidate for, or incumbent of a state or local elective office that (1) is directly or indirectly responsible for, or can influence the outcome of, the selection of an SBS dealer by a municipal entity, or (2) has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the selection of an SBS dealer by a municipal entity.

Covered Associates. A covered associate includes:

- Any employee who solicits security-based swap business from a municipal entity on behalf of an SBS dealer;

Political Law Alert

-
- Any person who directly or indirectly supervises such solicitor;
 - General partner, managing member or executive officer (the president; vice president in charge of a principal business unit, division, or function; other officer or person who performs policy making function); and
 - Any political action committee controlled by the SBS dealer or a person listed above.

Look-Back for New Covered Associates. For an employee who becomes a covered associate for the first time by soliciting security-based swap business, the contributions he or she made during the prior two years to an official of the municipal entity would trigger a ban for the SBS dealer. Other new covered associates have a shorter six-month look-back. Thus, when an employee becomes a covered associate for the first time, one must “scrub” that employee to make sure he or she has not made a covered contribution during the relevant look-back period. The look-back will not cover contributions made prior to the rule’s compliance date.

Exemptions

- There is an exemption for an individual who contributes no more than \$350 per election to a candidate for whom he or she is entitled to vote, or \$150 per election to a candidate for whom he or she is not entitled to vote.
- If an individual contributes within the \$350 per election limit but is not entitled to vote for the candidate, there is an automatic exemption if (1) the SBS dealer discovers the contribution within 120 days and (2) a refund is obtained within 60 days of discovery. An SBS dealer may use this automatic exemption only twice during a 12-month period (three times if it has more than 50 covered associates) and only once in a lifetime for any one covered associate.
- A security-based swap that is executed on a registered national securities exchange or registered or exempt security-based swap execution facility (these are the regulated trading platforms for security-based swaps) is exempt if the SBS dealer

does not know the identity of the counterparty a reasonable sufficient time prior to execution of the transaction to comply with the ban. This is a deviation from CFTC 23.451, which made the exemption unavailable if a swap dealer learned the identity of the counterparty before execution.

- An SBS dealer may seek from the SEC a discretionary exemption, where the SEC will consider a variety of factors, including but not limited to the sufficiency of the SBS dealer’s compliance procedures, whether the SBS dealer had knowledge of the contribution before it was made, and the remedial steps, if any, the SBS dealer took after discovering the contribution.

Ban on Soliciting Political Contributions. The rule prohibits an SBS dealer and its covered associates from soliciting or coordinating political contributions on behalf of (1) an official of a municipal entity with which the SBS dealer is offering to enter into, or has entered into, a security-based swap, or (2) a political party of the state or locality where the SBS dealer is offering to enter into, or has entered into, a security-based swap or trading strategy involving a security-based swap.

Prohibition on Paying Unregulated Third Parties to Solicit Municipal Entities. An SBS dealer is prohibited from providing or agreeing to provide, directly or indirectly, any payment to any person, including but not limited to an affiliate, to solicit a municipal entity to offer or enter into a security-based swap with that SBS dealer unless the person is also subject to a pay-to-play rule imposed by the CFTC, SEC or a self-regulatory agency subject to CFTC or SEC jurisdiction.

Other Pay-to-Play Restriction. Rule 15Fh-5(a)(1)(vi) requires that SBS dealers and major swap participants have a reasonable basis to believe that third-party representatives of governmental special entity counterparties are subject to pay-to-play restrictions imposed by the CFTC, SEC or a self-regulatory organization subject to CFTC or SEC jurisdiction.

Indirect Violations. An SBS dealer or covered associate is prohibited from doing indirectly what it is prohibited from doing directly.

Political Law Alert

Additional Contacts in the Political Law Group

Matthew Bobys

Counsel
202.371.7739
matthew.bobys@skadden.com

Charles M. Ricciardelli

Associate
202.371.7573
charles.ricciardelli@skadden.com

Jeremy F. Regan

Associate
202.371.7073
jeremy.regan@skadden.com

Melissa L. Miles

Counsel
202.371.7836
melissa.miles@skadden.com

Tyler Rosen

Associate
202.371.7035
tyler.rosen@skadden.com

Kelvin Reese

Head Political Reports Analyst
202.371.7498
kelvin.reese@skadden.com

Patricia M. Zweibel

Counsel
202.371.7089
patricia.zweibel@skadden.com

Shayla K. Parker

Associate
202.371.7534
shayla.parker@skadden.com