

D.C. Circuit Raises the Bar on SEC Review of SRO Rule Filings—May Further Slow Pace of Agency Actions

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A recent decision by the D.C. Circuit Court of Appeals effectively raises the standard for SEC review and approval of rule change filings submitted by national securities exchanges, FINRA, and registered clearing agencies. This decision could materially slow down a process that is a critical path for most self-regulatory organization (“**SRO**”) business and regulatory initiatives. It could also embolden market participants who believe that they may be negatively affected by an SRO’s rule change to challenge the SEC’s approval on procedural grounds.

The case, *Susquehanna International Group, LLP, et al. v. SEC*, decided on August 8, involved a petition by two options exchanges and two broker-dealers (“**Petitioners**”) for review of an SEC order approving a proposed change by the Options Clearing Corporation (“**OCC**”) to its rules. The proposed rule set out a plan to bolster its capital by restructuring its capital contribution requirements, fees, rebates and dividends. The proposal was filed by the OCC in 2015 and the SEC issued an order approving the proposal in February 2016.

Petitioners argued that the proposal was defective based on a failure to meet the statutory standards applicable to SRO rule filings under the Securities Exchange Act of 1934 (the “**Exchange Act**”), including that the proposed rule does not impose an unfair burden on competition and equitably allocates the SRO’s fees. Petitioners also argued that the SEC’s order was defective on procedural grounds, since the SEC allegedly failed to make its own specific findings and determinations required in order to approve a clearing organization’s rule proposal, including that the proposal is consistent with the Exchange Act. While the SEC’s approval order recited that the Commission had made such findings and determinations, the court stated that the SEC “effectively abdicated” making the statutory determinations to OCC by relying on the OCC’s analysis and assertions, without independently questioning the OCC’s analysis or considering whether the relevant statutory criteria were actually met.

In reviewing SRO rule changes, the court held that the SEC must undertake its own “reasoned analysis,” not take the SRO’s “word for it” that statutory standards are met, and that SEC approvals may be set aside as being “arbitrary and capricious” unless its determinations are supported by “substantial evidence.” The court reviewed the SEC’s discussion of various aspects of the OCC proposal and found the agency’s analysis concerning the satisfaction of statutory standards to have been insufficiently probing.

The decision is likely to have little immediate impact on the OCC and its constituents, since the court did not vacate the SEC’s approval order but instead remanded it to the SEC to properly evaluate the proposal as required by the Exchange Act. As such, the OCC’s plan remains in effect until the SEC takes further action. However, the implications for the SEC’s handling of all SRO rule filings could be immediate and substantial.

Historically, the depth of the SEC’s review of SRO rule proposals has varied widely in practice. Typically, only a fraction of the hundreds of SRO rule approval orders issued each year contains a detailed discussion of the SEC’s findings and determinations. The SEC regularly relies on the SRO’s statements and analysis as to why the rule change satisfies the statutory criteria, without the level of independent scrutiny that the court suggests is required. The process for approval of SRO rule changes is chronically criticized by market participants as being too slow. If the SEC must enhance the analysis it conducts and the stated reasoning contained in its approval orders, it could further slow the processing of those SRO

rule filings that require affirmative SEC approval (notably, changes to SRO fees and certain administrative matters generally do not require affirmative SEC approval). The decision may also pave the way for market participants that are unhappy with SRO rule changes that have been approved by the SEC to mount court challenges.

This decision, when considered in conjunction with other recent judicial actions that have resulted in enhanced cost-benefit analysis in SEC rulemaking, such as the D.C. Circuit's 2011 [Business Roundtable](#) decision, along with [legislation](#) being considered in Congress that would, if enacted, impose yet further procedural requirements on the SEC, means that the SEC staff and the Commission itself will have to work even harder to analyze proposals and justify their decisions and actions in order to withstand court challenges. Under these circumstances, it will be increasingly difficult for the agency to move swiftly in taking regulatory actions.

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