

Treasury Report Recommends Additional Process and Constraints for Market Regulators

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The U.S. Treasury's new [Capital Markets Report](#) recommends additional administrative requirements for regulatory actions by the SEC and the CFTC (the "Agencies"). If adopted, the process by which the Agencies issue new regulations and guidance may be more transparent and subjected to more rigorous cost-benefit analysis. Rulemaking and issuing no-action relief would almost certainly be much slower and bureaucracy laden, however, which could make the Agencies less nimble and slower to respond to changing market needs. The Report also targets various FINRA and other self-regulatory organization ("SRO") practices with recommendations which, if implemented, would increase the Agencies' oversight of SROs, particularly with regard to their governance, transparency, conflicts of interest and the extent of their regulatory powers and immunities.

Treasury's key recommendations in this area include:

- The Agencies should avoid using no-action relief and other regulatory guidance "excessively" or "unjustifiably" to make substantive changes in rules without complying with the notice and comment process that ordinarily applies to agency rulemaking;
- The Agencies and SROs should review existing SRO rules, roles, responsibilities and capabilities and the related system of SRO oversight with a view to making structural improvements;
- The Agencies and SROs should enhance cost-benefit analysis in connection with their proposed rulemakings;
- When engaging in rulemaking, the Agencies should take into account the "core principles" for financial regulation contained in President Trump's Executive Order on [Core Principles for Regulating the United States Financial System](#), as well as earlier Executive Orders concerning [Regulatory Review and Planning](#) and [Improving Regulation and Regulatory Review](#);
- The Agencies should expand their solicitation of public input relating to rule proposals, including through the use of advance notices of proposed rulemaking;
- The Agencies should consider expanding their use of "principles-based regulation" approaches (as opposed to detailed, prescriptive rules) when proposing new rules; and
- The Agencies should harmonize their rules (including their cross-border application).

Although these recommendations would generally constrain Agency regulatory actions, Treasury recommends one important change that would expand the Agencies' authority, undoing a provision of Dodd-Frank that limits the Agencies' power to grant exemptions from certain OTC derivatives requirements under Title VII.

Interestingly, Treasury discusses at length the long-standing question of whether the Agencies should be merged to form a single regulator for securities and futures and other derivatives to achieve consistency of approach and budgetary efficiencies. Treasury ultimately declines to recommend a merger, on the basis that such a combination would not improve upon the current system.

The Report also seems to reflect a general skepticism by Treasury of major aspects of the current SRO system, particularly as it relates to securities exchanges and market data. Among the points that Treasury recommends be

considered in the Agencies' reviews of the SRO system are:

- Within specific categories of SROs, ensuring compliance by “outlier” SROs with their regulatory obligations;
- Controlling SRO conflicts of interest;
- SRO governance;
- Providing greater transparency regarding SRO fee structures, including alignment of fees with actual costs of regulation;
- Limiting regulatory immunity of SROs from private actions;
- Limiting surveillance, examinations and enforcement activities of an SRO to policing the SRO's own rules and limiting “duplicative” examinations and enforcement; and
- Changing the process for Agency review of SRO rulemaking “to manage the volume and priority of such rulemakings in a manner consistent with applicable laws.”

These recommendations come on the heels of a recent [court decision](#) that will compel the SEC to more closely scrutinize SRO rule changes.

Finally, the Report also includes extensive recommendations regarding the activities of SROs in relation to the regulation and structure of the equity markets, including proposals concerning exchange fee structures, dissemination of market data and the tick size at which certain stocks trade. These are described in a forthcoming companion post on the Report's discussion of equity market structure.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Annette L. Nazareth

+1 202 962 7075

annette.nazareth@davispolk.com

Zachary J. Zweihorn

+1 202 962 7136

zachary.zweihorn@davispolk.com

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