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REGULATORY REFORM

Five Takeways From the First Half Decade of Wall Street Reform

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On Wednesday, July 21, 2010, President Barack Obama signed the Wall Street Reform and Consumer Protection Act (Dodd-Frank) into law. H.R. 4173,[1] as it was known at the time, was described by the President as ''common-sense reforms to protect consumers and our economy as a whole.''[2] Dodd-Frank's origins extend back to March 2008 and then-Secretary of the Treasury Henry M. Paulson Jr.'s ''Blueprint for a Modernized Financial Regulatory Structure''[3] and the September 2009 G-20 Pittsburgh Summit.[4] In the subsequent months, Congress held series of hearings, considered dozens of legislative proposals to promote financial stability, and financial market participants descended on Washington to help shape the landmark legislation.

In the five years since President Obama's signing ceremony at the Ronald Reagan Building, Washington has seen many changes. The legislators whose names precede the law no longer serve in Congress; of the 528 members of the 111th Congress who voted on Dodd-Frank in 2010, 237 of them are no longer in office. The majority political party has changed in both legislative chambers, with Republicans now controlling the House and the Senate.

The Treasury Department has a new Secretary, the Securities and Exchange Commission (SEC) has a new Chair, and the Commodity Futures Trading Commission (CFTC) has a new Chairman. Of the current slate of SEC and the CFTCs Commissioners, only SEC Commissioner Luis Aguilar was serving when Dodd-Frank was signed into law. And, with November 2016 Presidential elections looming, the White House will have a new resident in 18 months.

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. (2010) (enacted), *available at*, http://www.gpo.gov/fdsys/pkg/BILLS-111hr4173enr/pdf/BILLS-111hr4173enr.pdf.

[2] *Remarks by the President at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act*, https://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act (last visited July 20, 2015).

[3] Department of the Treasury, *Financial Regulatory Reform, A New Foundation: Rebuilding Financial Supervision and Regulation* (2008), http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

[4] *Leaders' Statement, Pittsburgh Summit* (Sept. 24 – 25, 2009), https://g20.org/wp-content/uploads/2014/12/Pittsburgh_Declaration_0.pdf.

As the legislation continues to work its way through implementation, we continue to see legislative efforts to amend Dodd-Frank, significant work at the various regulatory agencies' rules (and subsequent interpretive guidance and no-action relief), as well as an increasing trend of investigations and enforcement actions for noncompliance. With the amount of activity taking place, there have been significant developments in each venue. This article identifies several of the key takeaways from the law's first five years.

1. The Financial Stability Oversight Council Remains a Work in Progress.

Pursuant to Dodd-Frank, the Financial Stability Oversight Council's (FSOC) purpose is, among other things, ''to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace.''[5] Most notably, the FSOC has undertaken the review of a number of nonbank financial companies to determine which company's material financial distress—or the nature, scope, size, scale, concentration, interconnectedness, or mix of its activities—could pose a threat to U.S. financial stability. To date, the FSOC has voted to designate four companies - American International Group, Inc., General Electric Capital Corporation, Inc., Prudential Financial, Inc.. and MetLife, Inc.

The recent designation of MetLife in December 2014 led to judicial challenge surrounding the FSOC's legal authority, procedures, and determination.[6] The case, filed and pending before the U.S. District Court for the District of Columbia, attempts to invalidate the FSOC's designation process and potentially unwind the FSOC's prior designations. Regardless of the case's ultimate outcome, the legal scrutiny and media attention has led the FSOC to amend some of its policies and procedures.

Beyond the ''systemically important'' designation process, the FSOC has also involved itself in a series of financial market regulatory issues. Each year, the FSOC delivers a report to Congress on its activities, describes significant financial market and regulatory developments, analyzes potential emerging threats, and makes certain recommendations. The 2015 report to Congress, for example, focuses on risks posed by cybersecurity, speculative behavior centralized clearing houses, financial market data gaps, and capital and liquidity.[7]

The FSOC has also analyzed specific market developments traditionally left to prudential regulatory authorities. To date, the FSOC has explored money market mutual funds,[8] implementation of the Volcker Rule,[9] and asset management products and activities.[10] In the future, the FSOC will continue to use its role as a forum for regulators to push individual agency's agendas as spur their counterparts' actions.

From a procedural standpoint, while the Metlife case may impact the FSOC's deliberative process, the institution also faces criticism from its members. For example, SEC Commissioners—from both sides of the aisle—have complained about access to FSOC data and deliberations. Democratic SEC Commissioner Luis Aguilar has remarked that ''[his] fellow Commissioners and [he] have very little control or input over the content and output of projects undertaken by FSOC, as well as the behavior, inputs, and conclusions supplied by others from the SEC working with FSOC and [Office of Financial Research].[11] Similarly, Republican SEC Commissioner Michael S. Piwowar has indicated concerns about limited SEC involvement because within the FSOC ''banking and prudential regulators exert substantial influence'' which ''represents an existential threat to the SEC and the other member agencies.''[12] These complaints have also come from Capitol Hill, with Members of Congress raising concerns about FSOC transparency[13] and introducing legislative proposals to amend the FSOC's operating procedures.[14]

2. Congress Continues to Play a Significant Role in Dodd-Frank Implementation and the Role of Regulatory Agencies.

Dodd-Frank, by design, deferred to the regulatory agencies on many of the nuanced policy decisions required to implement the legislation. However, as the past five years have shown, that deference does not mean Congress will not offer its thoughts on how the law should be interpreted and codified in regulation.

In that time, Congress has flexed its oversight muscle by holding scores of hearings on many of the key financial reform issues. Regulators have been compelled to testify before each of the committees of jurisdiction, where they have faced hostile questions from both ends of the political spectrum about policy decisions, pace of implementation, and second-guessing about how they appropriate agency resources to carry out their statutory obligations. The political dynamic of Republican-led legislature reviewing the work of Democratic-led regulatory agencies has sharpened the rhetoric of these communications, whether in hearings, press statements, letters, op-eds, or in conversations with market participants.

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5 Pub.L. 111-203 § 112(a)(1)(A).

6 Compl., *Metlife, Inc. v. Fin. Stability Oversight Council*, No. 15-45 (D.D.C. filed Jan. 13, 2015) (ECF No. 1) (PACER

7 Financial Stability Oversight Council, *Annual Report* (2015), http://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/2015%20FSOC%20Annual%20Report.pdf.

8 *Proposed Recommendations Regarding Money Market Mutual Fund Reform*, 77 Fed. Reg. 69,455 (Nov. 19, 2012).

9 *Public Input for the Study Regarding the Implementation of the Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds*, 75 Fed. Reg. 61758 (Oct. 6, 2010).

10 *Notice Seeking Comment on Asset Management Products and* Activities *[Docket No. FSOC-2014-0001]*, 79 Fed. Reg. 77,488 (Dec. 24, 2014).

11 Luis A. Aguilar, Commissioner, U.S. Securities & Exchange Commission, *Taking an Informed Approach to Issues Facing the Mutual Fund Industry* (Apr. 2, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370541390232.

12 Michael S. Piwowar, Commissioner, U.S. Securities & Exchange Commission, *Advancing and Defending the SEC's Core Mission* (Jan. 27, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370540671978.

13 *Garrett Denied Access to FSOC Meeting, Introduced Legislation to Bring Sunshine to* Council (Apr. 3, 2014), http://garrett.house.gov/media-center/press-releases/garrett-denied-access-to-fsoc-meeting-introduces-legislation-to-bring.

14 *See, i.e., FSOC Transparency and Accountability Act*, HR 4387 (113th Congress)

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Senators and Members of Congress have offered dozens of proposals on how to amend Dodd-Frank, ranging from minor ''tweaks'' or ''technical corrections'' to complete abolishment or major overhauls of the legislation. In fact, in the 113th Congress, Senator Richard Shelby (R-AL), now Chairman of the Senate Banking Committee, introduced legislation[15] designed to solely correct ''drafting errors'' and ''focuses purely on technical corrections of non-substantive inaccuracies and omissions in the statute.''[16] Other provisions frequently targeted by legislative proposals include cost-benefit analysis in rulemaking, application of provisions to commercial end-users, U.S. regional banks and other ''Main Street'' companies, changes to the Consumer Financial Protection Bureau's structure, swap data information sharing and indemnification requirements, as well as other broader derivatives measures.

One recent legislative initiative exemplifies how Congress can remain deeply involved and influential in financial reform measures, as well as how political dynamics can impact lawmarkers' positions and priorities.

The CFTC, the primary U.S. regulator for futures and swap markets, is statutorily authorized by the Commodity Exchange Act (CEA). By law, the CEA expired at the end of fiscal year 2013.[17] Congress worked, but failed, to pass CEA reauthorization in the 113th Congress. Debate surrounding the renewal of the CFTC's statutory authority has opened Dodd-Frank, particularly the derivatives title (Title VII), to new debate and reconsideration. In both the 113th and 114th Congress, the House of Representatives moved more quickly than the Senate, with the House Committee on Agriculture leading the effort and the full House successfully passed reauthorization bills. However, the Senate did not complete its work in the 113th Congress and legislation has yet to be introduced in the Senate in the 114th Congress.

After the House passed legislation in 2014 by a vote of 265-144,[18] including significant bipartisan support, the House Agriculture Committee began its deliberations in 2015 with substantially similar proposed reauthorization language. However, changes at the CFTC, including the confirmation of a new Chairman and two new Commissioners who ushered in commercial end-user relief, led some Democrats to call for less prescriptive reauthorization language and to give the CFTC more deference. The recent Republican-led House efforts to pass reauthorization legislation[19] caused the CFTC Chairman to pen a letter opposing the proposal[20] and the White House issued a statement of administration policy that the bill ''undermines the efficient functioning of the CFTC by imposing a number of organizational and procedural changes and offers no solution to address the persistent inadequacy of the agency's funding.''[21] As a result, many Democrats who voted ''yes'' in 2014 changed their position in 2015 and voted ''no'' during the chamber's most recent vote. The House bill passed along largely party lines by a vote of 246-171.[22]

The Senate, which is more resistant to amending any part of Dodd-Frank, has not yet formally begun consideration of CEA reauthorization. However, it appears unlikely that the resulting product coming out of both chambers will contain all of the House's provisions.

When Congress is not using its lawmaking authority, it frequently relies on the power of the purse to impose its will on regulatory agencies. The ability to constrain budgetary resources frequently allows Congress to attach conditions to the funding they provide the agencies.

Most recently, legislators have used the appropriations process to impact agencies' operations. In the House, appropriators are in the middle of completing a financial services spending package that would reduce funds for financial services regulatory agencies.[23] This proposal, according to its supporters, ''prioritizes critical national programs to enforce U.S. laws, maintain a fair and efficient judicial system, and help small businesses grow'' by ''reduc[ing] or eliminat[ing] lower-priority programs and cut[ting] funding to poor-performing agencies.''[24]

For example, SEC's budget would remain at $1.5 billion for another year, falling $222 million short of the Obama Administration's budget proposal. The current House proposal would also tie the Consumer Financial Protection Bureau to the Congressional appropriation process for the first time, rather than allowing it to draw funds from the Federal Reserve as set forth in Dodd-Frank. The CFTC's funding would remain at $250 million, the same as 2015 and well short of President Obama's budget request. The legislation would directly subject the Office of Financial Research and the FSOC to the appropriations process, and would also require a broad study on the costs and benefits of the rules and agencies created by Dodd-Frank. While these measures are unlikely to survive Senate budget measures and certainly would not overcome the White House's veto power, they are instructive to the continued tensions that exist on financial regulation between the Republican Congress and the Democratic regulatory agencies on their priorities and agendas for the upcoming year.

[15] S. 451, 113th Congress (2013)

[16] *Shelby Introduces Dodd-Frank Implementation Bill* (Mar. 5, 2013), http://www.shelby.senate.gov/public/index.cfm/newsreleases?ID=02835B2D-EF31-490D-8C32-5A62292750D2.

[17] 7 U.S.C. § 16(d).

[18] Customer Protetion and End User Relief Act, H.R. 4413, 113th Cong. (2014); Final Vote Results for Role Call 349 (June 24, 2014), http://clerk.house.gov/evs/2014/roll349.xml.

[19] Commodity End-User Relief Act, H.R. 2289, 114th Cong. (2015).

[20] Letter from Tim Massad, Chairman, CFTC to Rep. Mike Conaway, Chairman, House Committee on Agriculture (May 14, 2015)

[21] Office of Mgmt. & Budget, Exec. Office of the President, Statement of Administration Policy, H.R. 4413 – Customer Protection and End User Relief Act (2014), http://www.whitehouse.gov/sites/default/files/omb/legislative/sap/113/saphr4413h_20140619.pdf.

[22] H.R. 2289, Final Vote Results for Role Call 309 (June 9, 2015), http://clerk.house.gov/evs/2015/roll309.xml.

[23] Staff of H. Comm. On Appropriations, 114th Cong., FY 2016 Appropriations for Financial Services & General Government (Comm. Print 2015), http://appropriations.house.gov/uploadedfiles/bills-114hr-sc-ap-fy2016-fservices-subcommitteedraft.pdf.

[24] Press Release, U.S. House of Representatives, Committee on Appropriations, Appropriations Committee Approves Fiscal Year 2016 Financial Services Bill (June 17, 2015), http://appropriations.house.gov/news/documentsingle.aspx?DocumentID=394280.

3. The Administrative Procedure Act Is as Important as Ever.

The promulgation of any landmark legislation often results in a series of judicial challenges, substantive and procedural, and Dodd-Frank is no different. Building on the D.C. Court of Appeals decision in *Business Roundtable v. SEC*,[25] Dodd-Frank litigants have chipped away at recent financial regulation by claiming, among other things, inadequate cost benefit analysis was performed. This facet of rulemaking is complicated, as admitted by one regulator at a recent Congressional hearing, because financial regulation is hard to measure in terms of specific tangible costs and benefits due to limited availability of timely, accurate, and complete data.[26]

Cost-benefit analysis (or insufficient cost-benefit analysis) played an important role in judicial challenges to the CFTC's cross-border interpretive guidance, the CFTC's swap execution facility rulemaking, the CFTC's swap data reporting framework, and the SEC's conflict minerals disclosure rule. To date, litigants have had mixed results trying to replicate *Business Roundtable*, as courts have only found limited instances of insufficient cost-benefit analysis. For example, in the lawsuit focused on the CFTC's cross-border interpretive guidance, while the judge effectively dismissed the claims, the CFTC was forced to seek and review public comment on specific cross-border costs and benefits related to certain of the CFTC's regulations.[27]

Administrative Procedure Act compliance and cost-benefit analysis benchmarks remain buzz words on Capitol Hill. In the House legislation to reauthorize the CEA, legislators have included specific new requirements for the CFTC to follow certain procedures when reviewing staff action (i.e., exemptive relief, no-action relief, or interpretive guidance), as well as amendments to the CFTC's cost-benefit analysis framework. Other lawmakers, including House Financial Services Committee Chairman Jeb Hensarling (R-TX), frequently comment that they believe the agencies are falling short of certain administrative procedure requirements when promulgating Dodd-Frank regulations.[28] These critiques will continue after the rules have been written and focus instead on enforcement actions taken by regulators. In fact, the SEC's use of administrative law judges has recently become the target of criticism by policymakers, who have questioned the arrangement in terms of fairness, resources, and statutory authority.[29]

One Administrative Procedure Act development that merits further observation is what SEC Commissioner Daniel Gallagher calls ''shadow rulemaking.''[30] He refers to instances where an agency adopts a final rule that contains a provision that was not part of the initial proposal. The agency's justification is that the proposal contained a question on the topic and revised the regulation in response to comments on that question. Agencies must defend the revision as a ''logical outgrowth,'' the legal standard for administrative review. Commissioner Gallagher's recent criticism to a security-based swap data repository rule[31] for chief compliance officers[32] is one such instance where a response to question in the preamble to a proposed rule has been used as justification for a final rule provision not contemplated in the proposed rule.

4. Global Financial Regulators Are Committed to Harmonized, Coordinated Regulation.

Starting with the commitments of the 2009 G-20 Pittsburgh Summit, global financial market regulation has always required coordination among jurisdictions. To date, this has been accomplished with varying degrees of success through a range of venues, including bilateral negotiations, multilateral discussions, and focused efforts through multinational organizations.

Regulators have relied heavily on global organizations designed to foster dialogue among policymakers, such as the Financial Stability Board, the International Organization of Securities Commissions, the International Association of Insurance Supervisors, European Securities and Markets Authority (ESMA), and the Basel Committee on Banking Supervision. To date, the work of these organizations has mirrored much of the progress made in the United States, albeit on differing timeframes, including bank capital standards, the designation of systemically important financial institutions (both in the U.S. and globally), and regulation of over-the-counter derivatives markets.

Given the unique liquidity characteristics of many financial markets, activity tends to flow to jurisdictions with adequate, but not overly burdensome, regulation. For example, when the CFTC rapidly implemented certain Dodd-Frank provisions, some trading activity migrated to Europe and Asia where new rules are being formulated at a more deliberative pace. These instances have been instructive to future policymaking, where jurisdictions are cooperating to ensure that regulation is comparable in both substance but also effective dates. Most recently, the CFTC and ESMA both explored the mandatory clearing of certain swaps—nondeliverable forwards—and ultimately concluded that the short-term delay of a clearing mandate would allow for more appropriate global coordination.

The global regulation of insurance markets remains an important issue for policymakers. Dodd-Frank established a Federal Insurance Office (FIO), whose obligations under Dodd-Frank include ''to coordinate Fed-

[25] *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

[26] Statement of Doreen R. Eberley, Dir., Div. of Risk Mgmt. Supervision, FDIC *Regulatory Relief for Community Banks*, http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=98bf66a4-5c4e-4a4a-8919-17affb464c6c.

[27] Initial Response to District Court Remand Order in Securities Industry and Financial Markets Associationi, et al. v. United States commodity Futures Trading Commission, 80 Fed. Reg. 12555 (March 10, 2015)

[28] Press Release, U.S. House of Representatives. Comm. on Fin. Servs., *Hensarling on Dodd Frank's 4th Anniversary* (Jul. 23, 2014), http://financialservices.house.gov/news/documentsingle.aspx?DocumentID=388859.

[29] Jean Eaglesham, *SEC Fights Challenges to Its In-House Courts*, June 21, 2015, http://www.wsj.com/articles/sec-fights-challenges-to-its-in-house-courts-1434927977.

[30] Daniel M. Gallagher, Comm'r, SEC, *Dissenting Statement Regarding Adoption of Regulation of SDR and Regulation SBSR* (Jan. 14, 2015), http://www.sec.gov/news/statement/dissent-adoption-of-regulation-sdr-commissioner-gallagher.html

[31] Security-Based Swap Data Repository Registration, Duties, and Core Principles, 80 Fed. Reg. 14438 (Mar. 19, 2015).

[32] Rule 13n–11(h), Security-Based Swap Data Repository Registration, Duties, and Core Principles, 80 Fed, Reg, 14437 (Mar. 19, 2015).

eral efforts and develop Federal policy on prudential aspects of international insurance matters.''[33] To date, the FIO has issued a series of studies and reports, including its most recent annual report to Congress. In that report, the FIO addresses a series of international insurance policy issues, including the EU-U.S. Insurance Project, reinsurance collateral reform, supervision of internationally active insurance groups and global systemically important insurers, and standards for the resolution of troubled or failing insurers.[34]

In other areas, international harmonization is necessary to prevent future global financial market risk. For example, there are significant efforts underway to promote information sharing in a quick and efficient manner. Regulators are also working together on cybersecurity and data protection efforts. However, each regulator is compelled by the unique contours of its jurisdiction and must balance those interests against the need for global oversight.

5. Dodd-Frank May Not Prevent the Next Crisis.

Despite all of the protections contained in Dodd-Frank, many of the provisions were tailored to address factors that caused the 2008 financial crisis. That does not mean, however, that all risk has been taken out of global financial markets. Policymakers continue to debate whether the problem of ''too big to fail'' has been solved, but that will not be certain until the failure of a large, globally connected financial institution threatens market stability under Dodd-Frank's regulatory framework.

In recent months, the manipulation of financial benchmarks, including LIBOR and the WM/Reuters used in currency markets, has led to groundbreaking criminal penalties and monetary fines.[35] U.S. housing finance depends on the health and stability of government-sponsored entities Fannie Mae and Freddie Mac, which remain under conservatorship of the federal government. Market participants have raised concerns that regulation, including overly burden rules and increased capital and margin requirements, may impact liquidity formation and constrain capital markets activity. And, with so much market activity (fixed income, derivatives, commodities) driven through central counterparty intermediaries, some have alleged that the clearinghouses being relied upon by Dodd-Frank to centralize and mutualize counterparty risk may themselves pose systemic risk and merit additional scrutiny.

Regardless of the source, the next shock to financial markets is likely one not contemplated by the words of Dodd-Frank crafted five years ago in the midst of the credit crisis. At some point in the future, policymakers will craft new legislation designed to respond to the latest crisis.

Conclusion.

While we commemorate the fifth anniversary of Dodd-Frank's signing, the process of crafting, interpreting and implementing regulations continues while efforts are already underway to review and change both the underlying statute and the rules that are already on the books.

[33] 31 U.S.C. § 313(c)(1)(E).

[34] Federal Insurance Office, U.S. Department of the Treasury, *Annual Report on the Insurance Industry* (Sept. 2014), http://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/2014_Annual_Report.pdf.

[35] *See, e.g.*, Press Release, U.S. Commodity Futures Trading Commission, *CFTC Orders Five Banks to Pay over $1.4 Billion in Penalties for Attempted Manipulation of Foreign Exchange Benchmark Rates* (Nov. 12, 2014), http://www.cftc.gov/PressRoom/PressReleases/pr7056-14.