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Securities Alert

US Department of the Treasury: A Financial System That Creates Economic Opportunities—Capital Markets

In October 2017, the US Department of the Treasury (Treasury) published a report titled "A Financial System That Creates Economic Opportunities" (Treasury Report).[1] Treasury, under the direction of Secretary Steven T. Mnuchin, prepared the Treasury Report in response to Executive Order 13772 (Executive Order).[2] The Executive Order established a set of Core Principles consistent with which the financial markets should be regulated.[3]

The recommendations in the Treasury Report are organized in the following categories:

- Promoting access to capital for all types of companies, including small and growing businesses, through reduction of regulatory burden and improved access to investment opportunities;
- Fostering robust secondary markets in equity and debt;
- Appropriately tailoring regulations on securitized products to encourage lending and risk transfer;
- Recalibrating derivatives regulation to promote market efficiency and effective risk mitigation;
- Rationalizing and modernizing the US capital markets regulatory structure and processes; and
- Advancing US interests by promoting a level playing field internationally.[4]

This alert summarizes Treasury's recommendations related to the following sections of the Treasury Report: Access to Capital, Equity Market Structure, the Treasury Market, Corporate Bond Liquidity, Securitization, Derivatives, and Regulatory Structure and Process. As described herein, most of Treasury's recommendations can be accomplished through administrative action

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[1] US DEPARTMENT OF THE TREASURY REPORT, *A Financial System That Creates Economic Opportunities: Capital Markets* (2017) (hereinafter TREASURY REPORT).

[2] Executive Order 13772 was published on February 3, 2017. Treasury delivered four reports related to the Executive Order. The focus of the Treasury Report is capital markets, debt, equity, commodities and derivative markets, central clearing, and other operational functions. TREASURY REPORT, *supra* note 1, at 5.

[3] The Core Principles are as follows: empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth; prevent taxpayer-funded bailouts; foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry; enable American companies to be competitive with foreign firms in domestic and foreign markets; advance American interests in international financial regulatory negotiations and meetings; make regulation efficient, effective and appropriately tailored; and restore public accountability within federal financial regulatory agencies and rationalize the federal financial regulatory framework. TREASURY REPORT, *supra* note 1, at 3.

[4] TREASURY REPORT, *supra* note 1, at 6. The Treasury Report also made recommendations relating to "[e]nsuring proper risk management for central counterparties (CCPs) and other financial market utilities (FMUs) because of the critical role they play in the financial system."

by the Securities and Exchange Commission (SEC) or other regulators, rather than through congressional action.

Access to Capital

Treasury begins the Access to Capital section of the Treasury Report with a familiar discussion of the decline of initial public offerings (IPOs) and the number of public companies over the past two decades. This report, like the SEC's new leadership, is focused on practical and feasible ways to increase companies' access to public capital and to make it more attractive for companies to engage in the public markets. Treasury has identified a handful of concerns related to, among other things, compliance costs, limitations on access to investment opportunities, disclosure burdens, shareholder litigation risk and the role of proxy advisory firms, and has offered a series of related recommendations to attempt to alleviate the regulatory burden of those concerns. The recommendations include the following.

- **Remove Non-Material Disclosure Requirements.** In connection with concerns that certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)[5] create immaterial disclosure requirements, Treasury recommends repealing the sections of the Dodd-Frank Act that require disclosure related to conflict minerals, mine safety, resource extraction and chief executive officer (CEO) pay ratios. This recommendation is consistent with the Financial CHOICE Act of 2017 (CHOICE Act)[6] and would require congressional action. Should Congress decide these disclosure obligations are appropriate, or fail to act with respect to the CHOICE Act, Treasury recommends that the SEC act to exempt smaller reporting companies and emerging growth companies from these requirements.[7]

- **Eliminate Duplicative Requirements.** Consistent with the Fixing America's Surface Transportation Act (FAST Act),[8] Treasury recommends that the SEC amend Regulation S-K[9] to remove provisions that are duplicative. The FAST Act addresses various items of Regulation S-K, including incorporation by reference, Management's Discussion & Analysis, undertakings, and extensible business reporting language requirements.[10]

- **Permit Additional Pre-IPO Communications.** Emerging growth companies are currently permitted to communicate with certain institutional investors prior to the filing of a registration statement for a securities offering in order to gauge the level of interest in the offering.[11] Treasury recommends expanding this ability to "test the waters" for a potential securities offering to all companies instead of limiting this ability only to emerging growth companies.[12]

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[5] Pub. L. No. 111-203 (2010). The relevant provisions of the Dodd-Frank Act are conflict minerals (Section 1502), mine safety (Section 1503), resource extraction (Section 1504) and pay ratios (Section 953(b)).
[6] Financial CHOICE Act of 2017, H.R. 10, 115th Cong. § 441 (2017).
[7] TREASURY REPORT, *supra* note 1, at 29.
[8] Pub. L. No. 114-94 (2015).
[9] 17 C.F.R. Part 229.
[10] TREASURY REPORT, *supra* note 1, at 30. On October 11, 2017, the SEC proposed rule amendments to modernize and simplify certain disclosure requirements in Regulation S-K in accordance with the FAST Act. The SEC indicated that the proposed amendments are intended to modernize and simplify certain disclosure requirements in a manner that reduces the costs and burdens on registrants while continuing to provide all material information to investors, to improve the readability and navigability of disclosure documents, and to discourage repetition and disclosure of immaterial information.
[11] TREASURY REPORT, *supra* note 1, at 30.
[12] *Id.*

- **Address Concerns on Shareholder Proposals.** The Securities Exchange Act of 1934 (Exchange Act) Rule 14a-8[13] provides a mechanism for shareholders to submit proposals to companies in which they hold shares for inclusion in a company's proxy materials, subject to certain procedural and substantive requirements.[14] Such requirements include that the shareholder has held at least $2,000 or 1% of the company's shares for at least one year.[15] Treasury views certain of these parameters as outdated and recommends that the $2,000 holding requirement be revised (presumably increased). Treasury suggests that the SEC consider looking to a shareholder's ownership interest in a company as a percentage of such shareholder's net liquid assets to determine eligibility to submit a shareholder proposal, and also recommends revising resubmission thresholds to "promote accountability, better manage costs, and reduce unnecessary burden."[16]

- **Concerns on Class Action Litigation.** In order to shield public companies from the liability concerns associated with Section 10(b)[17] of the Exchange Act and Rule 10b-5[18] thereunder, Treasury recommends that the states and the SEC explore ways to alleviate the costs associated with securities litigation.[19]

- **Allow Business Development Companies to Use Securities Offering Reform.** Certain of the securities offering rules that provide additional flexibility in accessing the capital markets to most public reporting companies do not apply to business development companies (BDCs), even though BDCs are Exchange Act reporting companies. Treasury recommends that the SEC revise these rules to apply to BDCs.[20]

- **Modify Eligibility Requirements for Scaled Regulation.** The Treasury Report identifies a variety of reporting obligation exceptions or modifications provided to smaller reporting companies, non-accelerated filers and emerging growth companies. The limited requirements include extended time to file periodic reports, and exemptions from compliance with the auditor attestation requirement in Section 404(b) of the Sarbanes-Oxley Act.[21] Treasury recommends expanding eligibility to qualify as a smaller reporting company and non-accelerated filer to include entities with up to $250 million in public float (currently it applies only to entities with $75 million in public float), and expanding the time frame in which an emerging growth company can retain its status to up to 10 years (currently emerging growth companies lose such status after five years).[22]

- **Review Rules for Interval Funds.** To encourage investment in lower-cap public companies, as well as private companies, Treasury recommends that the SEC review rules related to interval funds in order to evaluate whether greater flexibility would encourage investment in such smaller public and private companies.[23]

- **Review and Consolidate Research Analyst Rules.** To improve access to capital for small and young companies, including by increasing sell-side research coverage for smaller public companies through the reduction of the costs of regulation and compliance, Treasury

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[13] 17 C.F.R. §240.14a-8.
[14] TREASURY REPORT, *supra* note 1, at 31.
[15] TREASURY REPORT, *supra* note 1, at 31–32.
[16] TREASURY REPORT, *supra* note 1, at 31–32.
[17] 15 U.S.C. § 78j(b).
[18] 17 C.F.R. 240.10b-5.
[19] TREASURY REPORT, *supra* note 1, at 33–34.
[20] TREASURY REPORT, *supra* note 1, at 34–35.
[21] Pub. L. 107–124, 116 Stat. 745, § 404(b) (2002).
[22] TREASURY REPORT, *supra* note 1, at 36–37.
[23] TREASURY REPORT, *supra* note 1, at 37.

recommends a holistic review of the Global Research Settlement,[24] currently applicable to 12 major broker-dealer firms, and of the research analyst rules promulgated by the SEC and the Financial Industry Regulatory Authority (FINRA).[25] In particular, Treasury suggests harmonizing the Global Research Settlement and research analyst rules to identify a single set of rules applicable to all financial institutions.

- **Increase Flexibility for Regulation A Tier 2.** Regulation A+[26] provides an exemption from registration for certain companies offering up to $50 million in securities in a year.[27] Regulation A issuers are permitted to use a scaled offering document and are subject to ongoing reporting requirements, and securities sold in certain Regulation A offerings are not subject to state "blue sky" requirements, among other benefits.[28] Under current SEC rules, Exchange Act reporting companies may not rely on the Regulation A exemption.[29] Treasury recommends that (1) the SEC expand Regulation A to permit Exchange Act reporting companies to participate in such offerings; (2) state securities laws be revised (or over-ridden by the SEC) to exempt secondary trading of such securities from registration under state law; and (3) the SEC increase the maximum Regulation A offering size from $50 million to $75 million per year.[30]

- **Crowdfunding.** The SEC's crowdfunding rules, which were required by the Jumpstart Our Business Startups Act (JOBS Act),[31] provide for an exemption from registration for offerings up to $1 million per year, provided certain requirements of the rules are met.[32] To address concerns about cost, complexity and alignment of investor incentives under the crowdfunding rules, Treasury recommends allowing single-purpose crowdfunding vehicles advised by a registered investment adviser, which could facilitate a type of syndicate investing model for crowdfunding offerings. In addition, to facilitate greater participation in such offerings, Treasury recommends that the rules' limits on investment be waived for accredited investors and that the rules be amended to base investment limits on the greater of annual income or net worth, rather than the lesser of the two. Finally, Treasury recommends increasing the maximum revenue requirement from $25 million to $100 million, and the one-year crowdfunding limit from $1 million to $5 million.[33]

- **Create Appropriate Regulatory Structure for Finders.** To facilitate access to capital for smaller companies with fewer resources that may have trouble identifying and locating potential investors, Treasury recommends that the SEC, FINRA, and the states propose a new regulatory regime for finders and other intermediaries to increase the resources available to smaller companies seeking capital.[34]

- **Allow Additional Categories of Sophisticated Investors to Participate in Regulation D Offerings.** Treasury recommends that the definition of "accredited investor" under

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[24] *See* Treasury Report, *supra* note 1, at 37 ("In 2003 and 2004, securities regulators settled with 12 major broker-dealer firms for conflicts of interest between their research analysts and investment bankers [Global Settlement]. Under the Global Settlement, broker-dealers were required to reform their structures and practices to insulate research analysts from investment banking pressures. The Global Settlement only applies to the firms that are parties to the settlement.") (footnote omitted).
[25] *See* Regulation AC and FINRA Rules 2241 and 2242.
[26] 17 C.F.R. § 240.15c2–11.
[27] Treasury Report, *supra* note 1, at 39.
[28] *Id.*
[29] *Id.*
[30] Treasury Report, *supra* note 1, at 39–40.
[31] 17 C.F.R. § 230.251.
[32] Treasury Report, *supra* note 1, at 40.
[33] Treasury Report, *supra* note 1, at 40–41.
[34] Treasury Report, *supra* note 1, at 43–44.

Regulation D[35] be expanded in order to increase access to exempt offerings to a greater number of investors. One of Treasury's suggestions is that the definition include any investor who is advised on the merits of making a Regulation D investment by a fiduciary, and similarly, that it include those who are considered to be qualified to make such a recommendation.[36]

- **Review Rules for Private Funds Investing in Private Offerings.** To promote diversification, Treasury recommends a review of the provisions of the Securities Act of 1933 (Securities Act)[37] and Investment Company Act of 1940 (Investment Company Act)[38] that restrict unaccredited investors from investing in a private fund containing Rule 506 offerings.[39]

- **Empower Investor Due Diligence Efforts.** With the goal of streamlining reporting and empowering investors, Treasury recommends that federal and state financial regulators, along with self-regulatory organizations (SROs), create a system of centralized reporting of individuals and firms that have been subject to adjudicated disciplinary proceedings or criminal convictions.[40]

Equity Market Structure

The Equity Market Structure section of the Treasury Report makes recommendations designed to minimize the impact that fragmentation may have on liquidity, address conflicts of interests, clarify certain best execution and trade through obligations of broker-dealers, and simplify order types. In many instances, these recommendations are designed not solely to enhance secondary market trading, but with the recognition that a more liquid secondary market is more likely to enhance capital formation. A common theme of Treasury's equity market structure recommendations is that the SEC move away from a "one size fits all" approach to regulation and adopt rules tailored to the size of a company. Such changes could improve the capital markets for smaller companies and less liquid securities.

The Treasury Report makes the following recommendations to address the above-described issues and to improve equity market structure.

- **Fragmentation of Liquidity and Promoting Liquidity in Less Liquid Stocks.** Treasury observes that competition between trading venues has resulted in market fragmentation, especially for thinly traded stocks that do not have volume sufficient to support trading on many venues.[41] Treasury recommends that issuers of less liquid stocks, in consultation with their underwriter and listing exchange, have the ability to select and limit the exchanges and venues on which their securities will trade. This would be done through the SEC's approval of an issuer's request for partial or full suspension of Unlisted Trading Privileges (UTP) for its securities.[42] Treasury believes that consolidating trading to fewer venues would

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[35] The term "accredited investor" includes, among others, banks; savings and loan associations; broker-dealers; investment companies; private business development companies; organizations described in section 501(c)(3) of the Internal Revenue Code; natural persons whose individual net worth, or joint net worth with their spouse, exceeds $1 million; trusts with total assets in excess of $5 million; and entities in which all of the equity owners are accredited investors. 17 C.F.R. § 230.501(a).
[36] TREASURY REPORT, *supra* note 1, at 44.
[37] 15 U.S.C. § 77(a).
[38] 15 U.S.C. § 80(b).
[39] 17 C.F.R. § 230.502(b); TREASURY REPORT, *supra* note 1, at 45.
[40] TREASURY REPORT, *supra* note 1, at 45.
[41] TREASURY REPORT, *supra* note 1, at 59–60.
[42] UTP permit the trading of securities on exchanges other than the listing exchange of the security. For example, a security listed on the New York Stock Exchange (NYSE) may be traded on other exchanges such as NASDAQ via UTP.

encourage market makers to provide more liquidity in less liquid issues.[43]

- **Dynamic Tick Sizes.** Treasury also recommends that the SEC permit issuers, in consultation with their listing exchange, to determine the tick size—or minimum trading increment—for trading of their stock across all exchanges.[44] Minimum tick sizes currently are set at one penny for most stocks, and Treasury questions whether this uniform approach is best. Specifically, Treasury predicts that more liquid stocks would likely have lower tick sizes and that less liquid stocks would likely have higher tick sizes, which would improve market quality.[45]

- **Maker-Taker Fees/Rebates and Payment for Order Flow.** Treasury is concerned that maker-taker fees/rebates and payment for order flow practices of some market centers have created misaligned order routing incentives for broker-dealers.[46] Treasury recommends that the SEC adopt a final rule implementing the 2016 proposed changes to Exchange Act Rules 600 and 606, which would require additional disclosures related to the routing and execution of orders.[47] Treasury also supports a pilot program to study the impact of reduced access fees on investors' execution costs or available liquidity. Treasury notes that this may be another area where tailoring the regulatory requirement based on stock liquidity may be appropriate. Treasury recommends that the SEC exempt transactions in less liquid securities from any restrictions on maker-taker rebates and payment for order flow if these exemptions would promote greater market making.[48]

- **Market Data.** Treasury recommends that the SEC and FINRA issue guidance or rules clarifying that broker-dealers may satisfy their best execution obligations by relying on the market data from Securities Information Processors (SIPs) instead of proprietary exchange market data feeds, to the extent broker-dealers do not otherwise subscribe to proprietary feeds. Treasury believes that this change could reduce competitive pressure for broker-dealers to subscribe to more costly proprietary feeds and thereby could help reduce barriers to entry for smaller broker-dealers. Treasury also recommends that the SEC recognize that markets for SIPs and proprietary market data feeds are not fully competitive, and that the SEC use its authority under the Exchange Act to determine whether fees charged by exclusive processors of market data are "fair and reasonable," "not unreasonably discriminatory," and equitably allocated when determining whether to approve SRO rule changes that set data fees. Finally, Treasury recommends that the SEC consider amending the Regulation National Market System (NMS)[49] to enable competing consolidators to provide alternatives to the SIPs. Treasury suggests that this competition could result in faster consolidation and distribution of data, improved breadth of data, and lower costs than SIP market data prices.[50]

- **Order Protection Rule.** The Order Protection Rule[51] effectively requires broker-dealers to route customer orders to the trading venue with the best "protected quote"[52]—the best bid or

[43] TREASURY REPORT, *supra* note 1, at 59–60.
[44] As companies grow and their liquidity profile changes, the companies could update their tick size. *See* TREASURY REPORT, *supra* note 1, at 61.
[45] TREASURY REPORT, *supra* note 1, at 60–61.
[46] In general, in a maker-taker market, market participants "taking" liquidity (executing against displayed orders) pay fees, while participants "providing" liquidity (by displaying orders) receive payment when their orders receive an execution. TREASURY REPORT, *supra* note 1, at 62.
[47] Proposed Rule: Disclosure of Order Handling Information, Exchange Act Release No. 78309 (July 13, 2016) [81 Fed. Reg. 49431 (July 27, 2016)].
[48] TREASURY REPORT, *supra* note 1, at 62–63.
[49] 17 C.F.R. § 242.600.
[50] TREASURY REPORT, *supra* note 1, at 63–64.
[51] 17 C.F.R. § 242.611.

offer price.[53] Treasury observes that while this requirement has helped foster quote competition among exchanges, it also has been criticized for contributing to market fragmentation.[54] Specifically, the Treasury Report explains that the rule contributes to market fragmentation by requiring broker-dealers to check prices at each exchange, including exchanges that rarely have significant liquidity. Treasury recommends that the SEC consider amending the Order Protection Rule to provide protected quote status only to exchanges that provide meaningful liquidity and opportunities for price improvement based on a minimum liquidity threshold.[55] In connection with this suggestion, Treasury recommends that the SEC consider issuing interpretative guidance concerning whether a broker-dealer could satisfy its best execution obligations without checking the best bid or offer available on exchanges without protected quote status.[56]

- **Reducing Complexity in Equity Markets.** Treasury explains that exchanges and other trading venues compete by making various order types available to their users.[57] Treasury further notes that one source estimates that exchanges offer 2,000 variations of order types and that some large institutional investors are concerned that other short-term traders, such as high-frequency trading firms, may exploit these order types.[58] To reduce complexity, Treasury recommends that the SEC review whether exchanges and alternative trading systems (ATSs) should harmonize their order types and make recommendations as appropriate. Treasury also recommends that the SEC consider whether order types that are not frequently used should remain.[59]

- **Regulation ATS.** The Treasury Report describes the growth in securities traded on ATSs and the disparate oversight of ATSs and national securities exchanges.[60] Treasury recommends that the SEC adopt its 2015 proposed amendments[61] to Regulation ATS[62] focused on increasing the public information available about ATSs that trade (NMS) stocks and to better facilitate SEC oversight over those ATSs. In response to comments about the breadth of the proposed disclosures, Treasury recommends that the SEC only require the disclosure of confidential information to the SEC if the agency can demonstrate that it would provide better oversight of the industry. Treasury also recommends that the SEC consider ways to simplify the disclosures to reduce the compliance burden, and increase the readability and comparability across competing ATSs.[63]

The Treasury Market

The Treasury Market section of the Treasury Report focuses on advances in technology that have facilitated growth in electronic trading for large segments of the US Treasury market.[64] The

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[52] A protected quotation is a "quotation in an NMS stock that is displayed in an automated trading center; disseminated pursuant to an effective national market system plan; and is an automated quotation that is the best bid or best offer of a national securities exchange," the Nasdaq Stock Market, Inc., or another national securities association. 17 C.F.R. § 242.600 (2016).
[53] TREASURY REPORT, *supra* note 1, at 65.
[54] TREASURY REPORT, *supra* note 1, at 64.
[55] The minimum liquidity threshold could be measured as a percentage of the average daily trading volume executed on the particular exchange versus the volume of all such securities transactions executed on all exchanges. *See* TREASURY REPORT, *supra* note 1, at 65.
[56] TREASURY REPORT, *supra* note 1, at 64–66.
[57] TREASURY REPORT, *supra* note 1, at 66.
[58] *See* TREASURY REPORT, *supra* note 1, at 66.
[59] TREASURY REPORT, *supra* note 1, at 66.
[60] TREASURY REPORT, *supra* note 1, at 55.
[61] Proposed Rule: Regulation of NMS Stock Alternative Trading Systems, Exchange Act Release No. 76474 (November 18, 2015) [80 Fed. Reg. 80998 (December 28, 2015)].
[62] 17 C.F.R. § 242.301.
[63] TREASURY REPORT, *supra* note 1, at 66-67.
[64] TREASURY REPORT, *supra* note 1, at 71.

growth in electronic trading has resulted in the roles of certain intermediaries, such as dealers, shifting, and new intermediaries, including principal trading firms (PTFs), entering the market. Treasury believes that these changes have resulted in the need for additional safeguards so that it has the information it requires to understand market activity and to prevent additional risk in the market.

The Treasury Report recommends the following to address these issues and to improve US Treasury market structure overall.

- **PTF Trade Reporting.** PTFs—which account for the majority of activity and over half of the transaction volume in the electronic interdealer market—are not regulated, because they do not meet the definition of "dealer"[65] as set forth in the Exchange Act.[66] As a result, PTFs also are not required to become members of FINRA or to report their activity to FINRA's Trade Reporting and Compliance Engine (TRACE).[67] The trading activity of PTFs with interdealer brokers (which are registered broker-dealers and FINRA members), however, is reported to TRACE by the interdealer brokers.[68] Yet FINRA rules do not require interdealer brokers to identify their unregistered PTF trade counterparts[69] in trade reports, which has resulted in a significant portion of counterparty information being anonymized in TRACE data. To alleviate this gap in market data, Treasury recommends that US Treasury trading platforms operated by FINRA member broker-dealers be required to identify their customers in US Treasury security transactions reported to TRACE.[70]

- **Bank Trade Reporting.** Treasury remarks that similar to PTFs, there is a market data gap with respect to the activity of certain Federal Reserve bank members that conduct a government securities business under the Government Securities Act of 1986.[71] These banks are not members of FINRA and therefore are not required to report their trading activity to TRACE. In 2016, the Federal Reserve Board announced plans to collect data from banks relating to US Treasury securities trading, and Treasury supports these efforts.[72]

- **Treasury Futures Data Availability.** Treasury also does not have regular access to the market data for US Treasury futures transactions. This data currently is collected by the US Commodity Futures Trading Commission (CFTC) from the Chicago Mercantile Exchange Group, Inc. (CME Group), but is not shared with other market regulators or Treasury on a regular basis. To enhance cross-market monitoring of US Treasury cash and futures trading, Treasury recommends that the CFTC share its US Treasury futures securities transaction data with Treasury daily.[73]

- **Treasury Market Central Clearing.** While historically the majority of US Treasury activity has been cleared through the Fixed Income Clearing Corporation (FICC), PTFs are not FICC members, so transactions between PTFs must be settled bilaterally.[74] To enhance the

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[65] "Dealer'' means "any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person." 15 U.S.C. § 78(a)(5).
[66] TREASURY REPORT, *supra* note 1, at 79.
[67] In July 2016, the SEC approved a FINRA rule proposal to require its members to report transactions in securities to TRACE. FINRA began collecting this information in July 2017. TREASURY REPORT, *supra* note 1, at 79.
[68] TREASURY REPORT, *supra* note 1, at 80.
[69] Instead, on trade reports, the PTF counterparty is only generically identified as a customer. TREASURY REPORT, *supra* note 1, at 80.
[70] *See* TREASURY REPORT, *supra* note 1, at 80.
[71] Pub. L. No. 99–571.
[72] TREASURY REPORT, *supra* note 1, at 80–81.
[73] TREASURY REPORT, *supra* note 1, at 80.
[74] Transactions between PTFs conducted on electronic interdealer broker platforms can be centrally cleared when the transaction is cleared through the FICC account of the electronic platform. TREASURY REPORT, *supra* note 1, at 81.

netting of US Treasury activity and otherwise reduce the risk of failures, Treasury recommends further study of clearing and settlement arrangements and the consequences of reform options available in the clearing of US Treasury securities by regulators and market participants.[75]

- **Effect of Regulation on Secured Repurchase Agreement (Repo) Financing.** Treasury repos play a central role in US securities financing.[76] Treasury generally acknowledges that the Basel III capital requirements have had an adverse impact on repo financing since the financial crisis (Great Recession). Treasury recommends various modifications geared toward improving regulatory coherence to enhance how capital markets function, recalibrating US implementation of certain international financial regulatory standards, and applying enhanced prudential standards for foreign banking organizations based on their US footprints rather than their global consolidated assets. Treasury believes that these modifications will improve the availability of secured repo financing and spur market liquidity and growth.[77]

Corporate Bond Liquidity

The Corporate Bond Liquidity section of the Treasury Report focuses on market structure and intermediation and liquidity. The corporate bond market provides fixed income to investors and aids companies growing their businesses.[78] Treasury acknowledges that bank dealers play a vital role in the secondary market for corporate bonds as market makers, acting as a "provider of liquidity and facilitator of capital markets activity."[79] However, Treasury has found that restrictions posed by the Volcker Rule[80] of the Dodd-Frank Act have reduced bank market-making activity and liquidity.[81] Treasury recommends relieving certain compliance restrictions imposed by the Volcker Rule in order to improve market-making activity and secondary market liquidity. Namely, the Volcker Rule should not apply to banks with $10 billion or less in assets.[82] In addition, the Volcker Rule's proprietary trading restrictions should not apply to banks with greater than $10 billion in assets, unless those banks exceed a threshold amount of trading assets and liabilities.[83] Treasury also proposes multiple ways to alleviate the Volcker Rule's complexity by lowering regulatory compliance burdens. For example, Treasury recommends simplifying the definition of "proprietary trading"[84] to "allow banks to more easily hedge their

[75] TREASURY REPORT, *supra* note 1, at 81.
[76] TREASURY REPORT, *supra* note 1, at 75. Repo transactions are used by market intermediaries to finance long positions in US Treasury securities. TREASURY REPORT, *supra* note 1, at 75.
[77] US DEPARTMENT OF THE TREASURY REPORT, *A Financial System that Creates Economic Opportunities: Banks and Credit Unions* (2017), pp. 14 [hereinafter *Banks and Credit Unions*]. First, Treasury recommends that the Basel III capital requirement's supplementary leverage ratios (SLRs) and enhanced supplementary leverage ratios (ESLRs) be adjusted. Specifically, Treasury recommends "exceptions from the denominator of total exposure for cash on deposit with central banks, US Treasury securities, and initial margin for centrally cleared derivatives." Second, Treasury recommends recalibrating "the US Global Systematically Important Banks (G-SIB) risk-based capital surcharge, including its treatment of short-term wholesale funding reliance." Finally, Treasury recommends constructing "prudential standards for Foreign Banking Organizations on US risk profile rather than global consolidated assets," and increasing "the threshold for Intermediate Holding Companies from the $50 billion level for participation in the US Comprehensive Capital Analysis and Review." TREASURY REPORT, *supra* note 1, at 82.
[78] TREASURY REPORT, *supra* note 1, at 85.
[79] TREASURY REPORT, *supra* note 1, at 86.
[80] 12 U.S.C. § 1851 (2010).
[81] TREASURY REPORT, *supra* note 1, at 86–87.
[82] *Banks and Credit Unions*, *supra* note 77, at 14.
[83] *Id.*
[84] Proprietary trading is defined as "engaging as a principal for the trading account of the banking entity or nonbank financial company supervised by the Board in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may . . . determine." H.R. 4173, 111th Cong. § 619(h)(2) (2010).

risks and conduct market activities."[85] Similarly, Treasury recommends modifying the covered funds provisions and refining the definition of a covered fund,[86] thereby decreasing unnecessary burdens.[87]

Securitization

Acknowledging both the benefits of securitization as a financing tool and the role of securitized products in the Great Recession, the Securitization section of the Treasury Report describes the increased regulatory burden placed on these products after the financial crisis, and provides recommendations to alleviate or recalibrate certain of these burdens. The Treasury Report discusses how the pooling of cash flows to create new, more readily tradable securities allows for the diversification of credit risk associated with the underlying collateral and facilitates improved liquidity.[88] After discussing the benefits of securitization, Treasury describes the increased regulatory scrutiny and burden placed on securitized products to address the abuses and the negative perception of securitization resulting from the Great Recession.[89] Treasury points to rules related to bank capital, liquidity, risk retention and disclosures that broadly "add unnecessary cost and complexity" to the securitization process and, ultimately, to securitized products, without consideration of the differences and performance history across securitized products.[90] Treasury has made the following recommendations to address concerns that current regulations discourage securitizations and subject high-quality securitized products to punitive treatment.

- **Capital Requirements.** Observing that "[c]apital requirements should neither encourage nor discourage funding through securitization," the Treasury Report discusses various approaches to address the risk-based capital treatment of securitized products by various regulations applicable to US banks. Treasury identifies aspects of these approaches that ultimately discourage funding through securitization by treating capital requirements for holding securitized products differently from the capital requirements for holding the same underlying assets in disaggregated form. To address these issues, Treasury recommends (1) adjusting the parameters of the Supervisory Formula Approach (SFA) and the Simplified Supervisory Formula Approach (SSFA)[91]; and (2) aligning the current 20% risk weight floor for securitization exposures with the current Basel recommendation of 15%.[92] Additionally, Treasury observes that under the current accounting treatment, there is a potential that a sponsoring bank may end up holding duplicative capital against the same exposure for certain securitized asset classes. To address this, Treasury recommends that bank capital for securitization exposures sufficiently account for the magnitude of the credit risk sold or transferred in determining required bank capital, instead of tying capital to the amount of the trust that is consolidated for accounting purposes.[93] With respect to capital requirements for

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[85] *Banks and Credit Unions*, *supra* note 77, at 14.
[86] Covered funds, which are hedge funds or private equity funds, are defined as "an issuer that would be an investment company, as defined in the Investment Company Act of 1940, but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may . . . determine." H.R. 4173, 111th Cong. § 619(h)(4) (2010).
[87] *Banks and Credit Unions*, *supra* note 77, at 14–15.
[88] *See* TREASURY REPORT, *supra* note 1, at 91.
[89] *See* TREASURY REPORT, *supra* note 1, at 95.
[90] *See* TREASURY REPORT, *supra* note 1, at 97.
[91] Treasury recommends adjusting the parameters of the SFA and SSFA by not increasing (or, ideally, by decreasing) the 50% supervisory surcharge (i.e., the p factor) and by recognizing, under the SSFA, the added credit enhancement in existence when a bank holds a securitization at a discount to par value. *See* TREASURY REPORT, *supra* note 1, at 97.
[92] 12 C.F.R. § 217.144.
[93] Under GAAP, even when risk has been effectively sold or transferred to investors through the issuance of asset-backed notes, a sponsoring bank that maintains a controlling financial interest in the vehicle may still be required to hold capital against the underlying assets (if it is required to consolidate asset-backed securitizations (ABS) trusts onto its balance sheet). *See* TREASURY REPORT, *supra* note 1, at 98.

securitized products held on banks' trading books, Treasury recommends considering the impact that capital standards, such as the new Fundamental Review of the Trading Book (FRTB) standard, would have on secondary market activity, and recalibrating any capital requirements to prevent the required amount from exceeding the maximum economic exposure of the underlying bond.[94] Furthermore, as it relates to capital requirements and the stress testing of trading books, Treasury encourages the Federal Reserve Board to consider adjusting the global market shock scenario for trading exposures, to more fully consider the credit quality of the underlying collateral and reforms implemented since the Great Recession.[95]

- **Liquidity Requirements.** This portion of the Treasury Report focuses on US banking regulators' implementation of rules modeled after two global liquidity standards introduced by Basel III following the Great Recession—the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). Treasury notes that although the final LCR rules included a framework to permit regulators to consider including non-agency residential securities under a category of high-quality liquid assets (HQLA), US banking regulators decided to exclude all non-agency securitized products from any category of HQLA despite recent market changes and without consideration of the particular products' seniority or performance history.[96] Treasury recommends that high-quality securitized obligations with a proven record of accomplishment be given consideration as level 2B HQLA for purposes of LCR and NSFR. Treasury encourages regulators to use a prescribed framework like that used to determine the eligibility of investment-grade corporate debt.[97]

- **Risk Retention.** The Treasury Report addresses the 2014 joint Credit Risk Retention Rulemaking[98] that requires, with limited exceptions, the sponsor of asset-backed securitizations (ABS) to retain an economic interest in the credit risk of the structure. That rulemaking provides exemptions from risk retention for certain qualified mortgages and other assets. After criticizing the regulators for not undertaking a robust economic analysis on the impact of required thresholds for these exemptions, Treasury recommends that regulators engage in rulemaking to expand qualifying exemptions across eligible asset classes based on the unique characteristics of each securitized asset class. Treasury also recommends a review of the mandatory five-year holding period for certain third-party purchases and sponsors of commercial mortgage securitizations and nonqualified residential mortgage securitizations to allow for a reduction in the retention period where the emergence period for underwriting-related losses is shorter than five years. With respect to collateralized loan obligation (CLO) managers, Treasury recommends that regulators introduce a broad, qualified exemption by creating a set of loan-specific requirements under which CLO managers would receive relief from being required to retain risk. Separately, because the Credit Risk Retention Rulemaking was promulgated by six regulators, Treasury recommends Congress designate a lead agency to avoid coordination challenges in

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[94] *See* TREASURY REPORT, *supra* note 1, at 99 ("The revised standard increases capital requirements for securitizations by changing the capital calculation under the current trading book capital requirements to a revised standardized approach for market risk. Under this approach, banks would be required to hold capital sufficient to withstand large credit spread shocks in securitized products held for trading, even if the severity of those shocks are disconnected from the credit quality of the underlying collateral.").

[95] *See* TREASURY REPORT, *supra* note 1, at 99 ("Currently, the Federal Reserve's global market shock assumptions for the trading book require banks to apply the peak-to-trough changes in comparable asset valuations from the 2007–09 period without sufficiently tailoring such shocks to the collateral quality or safeguards implemented since the crisis. For example, under the Comprehensive Capital Analysis and Review [CCAR], a AAA-rated non-agency residential security is subject to a price shock of 31.5%, regardless of the quality of the mortgages collateralizing the exposure and the expected associated price decline.") (footnote omitted).

[96] Final Rule: Liquidity Coverage Ratio: Liquidity Risk Measurement Standards (September 3, 2014) [79 Fed. Reg. 61440 (October 10, 2014)].

[97] TREASURY REPORT, *supra* note 1, at 100–101.

[98] Final Rule: Credit Risk Retention [79 Fed. Reg. 77602 (December 24, 2014)].

connection with the publication of future interpretive guidance or exemptive relief.[99]

- **Disclosure Requirements.** The Treasury Report discusses the increased cost and compliance burdens associated with the post-financial crisis loan-level disclosure requirements for certain types of ABS under SEC Regulation AB II.[100] To bring the regulation in line with the principles-based disclosure requirement, Treasury recommends a review and recalibration of the asset-level data and a reduction of the up to 270 reportable, unique loan-level data fields.[101] To increase flexibility and decrease the cost to issue without sacrificing transparency, Treasury supports a "provide or explain [disclosure] regime" whereby certain asset-level data fields are required and the others may be omitted so long as the prospectus identifies the omitted fields and includes an explanation for the omission. Encouraging the further standardization of required data fields, Treasury also recommends a review, and potential reduction, of the three-day waiting period to go to market. Finally, Treasury encourages the SEC to signal to the industry that it will not extend Regulation AB II disclosure requirements to unregistered Rule 144A offerings or to additional securitized asset classes.[102]

Derivatives

The Derivatives Section of the Treasury Report focuses on simplifying, harmonizing and increasing legal certainty with respect to the regulation of derivatives. Specifically, Treasury recommends greater harmonization between the CFTC and the SEC on the application of uncleared margin, as well as both domestic regulators and their non-US counterparts on cross-border issues, such as substituted compliance and the activities of US personnel of foreign brokers.[103] The Treasury Report also takes a position on a number of long and hotly debated issues in the derivatives space, including the swap dealer de minimis threshold, the definition of nonfinancial entity, the treatment of segregated collateral in the calculation of the supplementary leverage ratio (SLR), and the bona fide hedge exemption under the proposed position limits rule.[104] Moreover, in the interest of providing greater legal certainty, the Treasury Report recommends that the CFTC review and, as appropriate, formalize existing no-action relief by revising its regulations.[105] The Treasury Report indicates that these and other recommendations would improve cross-border regulatory cooperation and would avoid market fragmentation, redundancies, undue complexity and conflicts of law.[106]

- **Harmonization Between the CFTC and SEC.** Treasury states that, while the Dodd-Frank Act imposed specific interagency coordination and consultation requirements on the SEC and the CFTC for certain rulemakings, the two agencies have approached many regulatory reforms independently, resulting in inconsistent or duplicative rules.[107] Examples of these differences touch all areas of the Dodd-Frank Act's over-the-counter (OTC) derivatives reforms, including differences in trade reporting requirements, trading and clearing rules,

[99] TREASURY REPORT, *supra* note 1, at 101–103.
[100] Final Rule: Asset-Backed Securities Disclosure and Registration, Exchange Act Release No. 9638 (September 4, 2014) [79 Fed. Reg. 57184 (September 24, 2014)] (Regulation AB II).
[101] *See* TREASURY REPORT, *supra* note 1, at 104 ("In Regulation AB, the SEC elected to set collateral-specific disclosure requirements at a principles-based level to prevent 'the accumulation of unnecessary detail, duplicative or uninformative disclosure and legalistic recitations of transaction terms that obscures material information.'").
[102] The additional asset classes include equipment loans or leases, floorplan financings, student loans, and revolving credit card debt. TREASURY REPORT, *supra* note 1, at 105.
[103] *See* TREASURY REPORT, *supra* note 1, at 126–36.
[104] *See* TREASURY REPORT, *supra* note 1, at 136–43.
[105] TREASURY REPORT, *supra* note 1, at 130–32.
[106] TREASURY REPORT, *supra* note 1, at 134–35.
[107] TREASURY REPORT, *supra* note 1, at 126. For example, under the Dodd-Frank Act, Title VII requires the SEC and the CFTC to coordinate and consult with each other and with prudential regulators before starting rulemaking or issuing an order on swaps or swap-related subjects.

compliance requirements for registration for swap dealers and security-based swap dealers, and capital and margin requirements, among others.[108] Treasury identifies the SEC's security-based swap dealer registration rules as a specific area of concern, observing that certain of the rules' compliance requirements have no comparable requirement under the CFTC's rules.[109] Treasury recommends that the CFTC and the SEC undertake and give "high priority" to a joint effort to review their respective rulemakings in each key Title VII reform area, with the purpose of harmonizing rules and eliminating redundancies to the fullest extent possible.[110] As part of this review, Treasury recommends that the SEC finalize its security-based swap rules with the goal of facilitating a well-harmonized swaps and security-based swaps regime.[111] In so doing, the agencies should consider "alternative compliance regimes" (i.e., a framework for substituted compliance or mutual recognition) for any areas in which effective harmonization is not feasible.[112] Treasury also recommends congressional review and action to achieve maximum harmonization in the regulation of swaps and security-based swaps.[113]

- **Margin Requirements for Uncleared Swaps.** The Treasury acknowledges that market participants have been critical of the final uncleared margin rules that the US banking agencies and the CFTC finalized for bank-affiliated swap dealers in November 2015[114] and for non-bank swap dealers in January 2016.[115] In general, these market participants argue that the US margin rules are more onerous in certain respects than the corresponding margin requirements promulgated by regulators in the EU and other G-20 jurisdictions.[116] Treasury observes that the current margin rules for uncleared swaps may place US firms at a competitive disadvantage relative to their non-US counterparts.[117] Treasury recommends that US regulators take steps to harmonize their margin requirements for uncleared swaps domestically and to cooperate with non-US jurisdictions that have implemented the Basel Committee on Banking Supervision-International Organization of Securities Commissions (BCBS-IOSCO) framework.[118] Treasury further recommends exemptions from initial margin requirements between bank affiliates of a bank that are consistent with those of the CFTC and non-US regulators.[119]

- **CFTC Use of No-Action Letters.** Treasury observes that the CFTC staff has issued a significant number of no-action and interpretive letters, staff letters, and various forms of guidance throughout the process of implementing the swaps reforms of the Dodd-Frank Act.[120] Although Treasury recognizes that such letters and guidance are important regulatory tools, particularly in light of the statutory rulemaking time frames under the Dodd-Frank Act, Treasury recommends that the CFTC take steps to simplify and formalize all outstanding staff guidance and no-action relief that has been used to assist the Dodd-Frank Act swaps implementation framework.[121]

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108 TREASURY REPORT, *supra* note 1, at 126.
109 *Id.*
110 TREASURY REPORT, *supra* note 1, at 127.
111 *Id.*
112 *Id.*
113 *Id.*
114 Final Rule: Prudential Regulators, Margin and Capital Requirements for Covered Swap Entities [80 Fed. Reg. 74840 (November 30, 2015)].
115 Final Rule: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (December 18, 2015) [81 Fed. Reg. 636 (January 6, 2016)].
116 TREASURY REPORT, *supra* note 1, at 128.
117 *Id.*
118 TREASURY REPORT, *supra* note 1, at 130.
119 *Id.*
120 *Id.*
121 TREASURY REPORT, *supra* note 1, at 132.

- **Cross-border Issues.** The Treasury Report examines the development of the CFTC's approach to implementing cross-border swap rules and observes that many challenges currently exist in the application of the CFTC's swaps jurisdiction to cross-border transactions.[122] Treasury acknowledges that market participants and non-US regulators have raised concerns that the application of US rules to cross-border swaps activities has resulted in conflicts and inefficiencies between US and non-US compliance regimes, in turn causing considerably higher operational costs and decreased competitiveness of US entities in relation to foreign entities.[123] Accordingly, Treasury recommends that the CFTC and the SEC (1) make their swaps and security-based swaps rules compatible with non-US jurisdictions (e.g., provide alternative ways for regulated entities to comply with requirements that may conflict with local privacy, blocking and secrecy laws); (2) adopt outcomes-based substituted compliance regimes (e.g., the CFTC and the SEC should be judicious when applying their swaps rules to activities outside the US and should permit entities, to the maximum extent practicable, to comply with comparable non-US derivatives regulations, in lieu of complying with US regulations); and (3) reconsider their approaches to transactions that are arranged, negotiated or executed by personnel in the United States (e.g., the CFTC and the SEC should reconsider the implications of applying their Title VII rules to transactions between non-US firms or between a non-US firm and a foreign branch or affiliate of a US firm merely on the basis that US-located personnel arrange, negotiate or execute the swap).[124]

- **Capital Treatment in Support of Central Clearing.** Treasury observes that the SLR imposes significant capital requirements on initial margin for centrally cleared derivatives. Banks that hold clearing customer client margin in the form of cash through their affiliate futures commission merchant (FCM) must also set aside the requisite 5% SLR, discouraging FCMs from clearing derivatives transactions for clients.[125] According to the Treasury Report, a recurring observation made by market participants is that the number of FCMs regulated by the CFTC has been cut in half since the adoption of the Dodd-Frank Act.[126] While Treasury acknowledges that there is no single cause for the exiting of FCMs, it is likely that increased regulatory costs have played a meaningful role in reducing the number of financial service providers and the corresponding increased concentration of FCMs.[127] Importantly, Treasury recommends that required capital should be reduced on centrally cleared transactions and that regulators should take a risk-adjusted approach for valuing options for purposes of the capital rules to better reflect the exposure (e.g., weighting options by their delta).[128] Further, Treasury recommends that in the future, regulatory capital requirements transition from the current exposure method to the BCBS-developed Standardized Approach for Counterparty Credit Risk calculation, which provides an offset for initial margin and recognition of appropriate netting sets and hedged positions.[129]

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[122] TREASURY REPORT, *supra* note 1, at 132–33.
[123] TREASURY REPORT, *supra* note 1, at 134. Market participants have raised similar concerns with aspects of the SEC's cross-border rules, and have highlighted conflicts with privacy, blocking and secrecy laws in non-US jurisdictions.
[124] TREASURY REPORT, *supra* note 1, at 134–36.
[125] TREASURY REPORT, *supra* note 1, at 136.
[126] *See* TREASURY REPORT, *supra* note 1, at 137; *see also* Acting Chairman J. Christopher Giancarlo, *Remarks before the International Swaps and Derivatives Association 32nd Annual Meeting* (May 10, 2017) (noting that the FCM marketplace has declined from 100 CFTC-registered entities in 2002 to 55 at the beginning of 2017), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-22.
[127] TREASURY REPORT, *supra* note 1, at 137.
[128] TREASURY REPORT, *supra* note 1, at 138.
[129] *Id.*

- **Swap Dealer De Minimis Threshold.** Treasury observes that when CFTC Rule 1.3(ggg) was finalized, the de minimis threshold was set at a phase-in level of $8 billion.[130] The Treasury Report acknowledges that market participants have called for the de minimis threshold to remain at $8 billion.[131] Indeed, Treasury observes that uncertainty with regard to the de minimis threshold may result in fewer counterparties, increased costs and reduced liquidity in the swaps markets, and creates adverse effects on certain commercial market participants' willingness to enter into risk-hedging transactions.[132] Treasury recommends that the CFTC maintain the swap dealer de minimis registration threshold at $8 billion and establish that any future changes to the threshold be subject to a formal rulemaking and public comment process.[133]

- **Definition of Financial Entity.** Treasury states that while Title VII's swaps clearing mandate provides an exception for non-financial entities using swaps to hedge or mitigate commercial risk,[134] "financial entity" is defined to include swap dealers, security-based swap dealers, major swap participants, major security-based swap participants, commodity pools, private funds and employee benefit plans.[135] Treasury places particular emphasis on the fact that the definition of "financial entity" includes a catch-all provision for persons "predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in section 1843(k) of title 12."[136] Treasury further notes that market participants continue to raise concerns and are uncertain about the scope of the financial entity definition and to seek further rulemaking or statutory solution. The Treasury Report supports a legislative amendment to Commodity Exchange Act (CEA) Section 2(h)(7)[137] to provide the CFTC with rulemaking authority to modify and clarify the scope of the financial entity definition and the treatment of affiliates (presumably with the goal of reducing the central clearing requirement).[138] Treasury notes that this proposed amendment should include consideration of non-prudentially regulated entities that currently may be considered "predominantly engaged . . . in activities that are financial in nature," but that may warrant exception for the clearing requirement if they engage in swaps primarily to hedge or mitigate the business risks of a commercial affiliate.[139]

- **Position Limits.** Treasury articulates that appropriately tailored position limits protect market participants from real threats of manipulation, cornering and other disruptive practices, but avoid hindering legitimate speculative activity.[140] Notably, Treasury emphasizes the importance of a hedging exemption, stating that "any [position limits] rule must not unnecessarily constrain end users in their ability to hedge. If end users are unable to hedge in an efficient and effective way, they may be discouraged from hedging at all."[141] The Treasury Report recommends that the final rules (1) ensure the appropriate availability of bona fide hedging exemptions for end users, (2) consider calibrating limits based on the risk of manipulation and (3) consider the deliverable supply holistically when setting the limits.[142]

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130 Treasury Report, *supra* note 1, at 139.
131 *Id.*
132 *Id.*
133 *Id.*
134 Treasury Report, *supra* note 1, at 140.
135 7 U.S.C. § 2(h)(7).
136 7 U.S.C. § 2(h)(7)(C)(i)(VIII).
137 7 U.S.C. § 2(h)(7).
138 Treasury Report, *supra* note 1, at 141.
139 *Id.*
140 Treasury Report, *supra* note 1, at 143.
141 *Id.*
142 *Id.*

- **Swap Execution Facility Execution Methods and Made Available to Trade Process.** Treasury observes that CFTC rules permit a swap execution facility (SEF) to make a made available to trade (MAT) determination, triggering the trade execution requirement for a class of swaps, on consideration of six specified factors.[143] Treasury notes that market participants have been critical of the current six factors that SEFs must consider before making a MAT determination. Noting that such factors may not adequately demonstrate whether a class of swaps has sufficient liquidity for mandatory trading,[144] Treasury recommends that the CFTC reevaluate the MAT determination process to ensure sufficient liquidity for swaps to support a mandatory trading requirement.[145] Generally, Treasury encourages the CFTC to encourage a broader range of trading mechanisms in recognition of the statutory goals of impartial access for market participants and promoting pre-trade price transparency in the swaps market.[146]

- **Swap Data Reporting.** Treasury notes that the CFTC has faced challenges in optimizing swap data ranging from data field standardization and data validation to analysis automation and cross-border data aggregation and sharing.[147] In July 2017, the CFTC announced a new review of the swap data reporting regulation in Parts 43, 45 and 49 of the CFTC's regulations.[148] Treasury supports the CFTC's newly launched "Roadmap" review in order to standardize reporting fields across products and swap data repositories, harmonize data elements and technical specifications with other regulators, and improve validation and quality control processes.[149] Specifically, Treasury recommends that the CFTC secure and commit adequate resources to complete the Roadmap review, undertake notice and comment rulemaking, and implement revised rules and harmonized standards within the time frame outlined in the Roadmap.[150] Treasury further recommends that the CFTC leverage third-party and market participant expertise to the extent necessary to develop a coherent, efficient and effective reporting regime.[151]

Regulatory Structure and Process

The Regulatory Structure and Process section of the Treasury Report outlines the regulatory landscape of the US capital markets, which consists of two segments—the securities markets and the derivatives markets. While acknowledging the importance of a strong financial regulatory framework in promoting economic growth and financial stability, and protecting financial institutions and investors, the Treasury Report also emphasizes the harmful effects of regulatory fragmentation, overlap, and duplication to taxpayers, consumers, and businesses. Although Treasury does not support merging the SEC and the CFTC because it does not believe that such action would appreciably improve the current system, Treasury makes the following recommendations to improve the regulatory structure and process.

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143 TREASURY REPORT, *supra* note 1, at 144–45.
144 *Id.*
145 TREASURY REPORT, *supra* note 1, at 145.
146 7 U.S.C. § 7b-3(f)(2)(B); 7 U.S.C. § 7b-3(e).
147 *See* TAC meetings and related documents *available at* http://www.cftc.gov/About/CFTCCommittees/TechnologyAdvisory/tac_meetings.
148 CFTC Letter 17-33, *Division of Market Oversight Announces Review of Swap Reporting Rules in Parts 43, 45, and 49 of Commission Regulations* (July 10, 2017).
149 TREASURY REPORT, *supra* note 1, at 147.
150 *Id.*
151 *Id.*

- **Restoration of Exemptive Authority.** Although both the SEC and the CFTC have general exemptive authority under Section 36(c) of the Exchange Act[152] and Section 4(c) of the CEA,[153] respectively, Congress curtailed such authority with respect to swaps activities covered under Title VII of the Dodd-Frank Act.[154] In light of the time provided to the SEC and the CFTC to monitor the swaps market since the enactment of the Dodd-Frank Act, Treasury recommends restoring the agencies' full exemptive authority. This change would allow the agencies to evolve with the marketplace, facilitate innovation and appropriately tailor the agencies' oversight to those activities posing the highest risk, among other things.[155]

- **Economic Analysis in Rulemaking.** The SEC and the CFTC are subject to statutory requirements to conduct a form of economic analysis during the rulemaking process.[156] In practice, the agencies take differing approaches to implementing economic analysis, with varying degrees of transparency on each agency's respective approach. To enhance transparency and consistency, Treasury recommends that the SEC and the CFTC apply the Core Principles for financial regulation outlined in various executive orders, and update and make publicly available their staff guidance for conducting economic analysis. Treasury also recommends extending the economic analysis guidance to the SRO rulemaking process.[157]

- **Using a Transparent, Common Sense, and Outcomes-based Approach.** Treasury recommends that the SEC and the CFTC conduct regular, periodic reviews of agency rules for burden, relevance and other factors, to identify and address outdated or ineffective rules. Treasury also encourages the agencies to solicit comments more frequently and, in advance of rule proposals, to signal to the public information that may be relevant. To avoid duplication, Treasury believes the SEC and the CFTC should continue their joint outcomes-based effort to harmonize their respective rules and the cross-border application of such rules.[158]

- **Regulatory Guidance Outside of Rulemaking.** The Treasury Report highlights the value of regulatory guidance and provides some of the mechanisms through which the SEC and the CFTC may publicly provide regulatory guidance outside of the notice and comment process. Understanding the value of such guidance and the need to balance such guidance with the danger of imposing regulatory requirements and burdens outside of the notice and comment process, Treasury urges the agencies to adopt the Office of Management and Budget's Final Bulletin for Agency Good Guidance Practices. Treasury also recommends that the CFTC and the SEC work to ensure that guidance is not being used excessively or unjustifiably to substantively amend rules without a notice and comment period. Treasury further recommends that the agencies review and revisit existing guidance.[159]

- **Update Definitions Under the Regulatory Flexibility Act.** Treasury recommends that the SEC and the CFTC review and update the definitions and application of the term "small entity"[160] in their various rules, for purposes of the impact analysis on small entities required

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[152] 15 U.S.C. § 78mm(c).
[153] 7 U.S.C. § 6(c).
[154] TREASURY REPORT, *supra* note 1, at 179.
[155] TREASURY REPORT, *supra* note 1, at 179–80.
[156] TREASURY REPORT, *supra* note 1, at 180.
[157] TREASURY REPORT, *supra* note 1, at 180–81.
[158] TREASURY REPORT, *supra* note 1, at 182.
[159] TREASURY REPORT, *supra* note 1, at 182–83.
[160] As described in the Treasury Report, the CFTC and the SEC have rules and practices for defining small entities. Treasury believes that the current rules and practices have resulted in the exclusion of entities that should be included within the definition of "small entity." TREASURY REPORT, *supra* note 1, at 184.

by the Regulatory Flexibility Act (RFA).[161] Treasury believes that the definitions should be reviewed to ensure that the RFA analysis appropriately considers the impact on persons who should be considered small entities based on monetary thresholds reflective of today's economy.[162]

- **Self-regulatory Organizations.** This section of the Treasury Report outlines the roles, responsibilities, and potential duplication and conflicts of interest associated with industry-led self-regulation in today's markets. Treasury recommends that the CFTC and the SEC conduct comprehensive reviews of the roles, responsibilities and capabilities of SROs under their respective jurisdictions, and make recommendations for operational, structural and governance improvements of the SRO framework. Treasury recommends that the agencies identify any required changes based on the outcome of their reviews. Treasury commends FINRA's self-initiated 360-degree review and encourages the National Futures Association and other SROs to conduct the same. Finally, Treasury recommends that each SRO adopt and publicly release an action plan to review and update its rules, guidance and procedures on a periodic basis.[163]

[161] 5 U.S.C. § 601.
[162] TREASURY REPORT, *supra* note 1, at 183–84.
[163] TREASURY REPORT, *supra* note 1, at 185–86.

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