


# ROADMAP FOR REGULATORY REFORM



MAY 2017

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May 2017



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The Committee's Roadmap for Regulatory Reform sets forth priority regulatory actions for the Trump Administration that would promote U.S. economic growth and enhance the stability of the U.S. financial system. We believe that prompt action is necessary because certain regulations implementing the Dodd-Frank Act have stifled U.S. economic growth and policymakers have paid inadequate attention to regulatory measures that would enhance the performance of U.S. capital markets.

The Committee is an independent 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations. The Committee's membership includes thirty-seven leaders drawn from the finance, business, law, accounting, and academic communities. The Committee Co-Chairs are R. Glenn Hubbard, Dean of Columbia Business School, and John L. Thornton, Chairman of the Brookings Institution. The Committee's Director is Hal S. Scott, Nomura Professor and Director of the Program on International Financial Systems at Harvard Law School.

Founded in 2006, the Committee undertook its first major report at the request of the incoming U.S. Secretary of the Treasury, Henry M. Paulson. Over ten years later, the Committee's research continues to provide policymakers with an empirical and non-partisan foundation for public policy.

The Committee believes that each of our recommended reforms is consistent with the President's Executive Order on Core Principles for Regulating the United States Financial System. We have therefore submitted this report to the Secretary of the Treasury to inform his response to the Executive Order.<sup>1</sup>

The Committee further believes that the Secretary's response to the President should not endorse any major legislative or regulatory reforms at this early stage. Instead, due to the complexity of the problem, the Secretary's response to the President could proceed in multiple stages, while prioritizing banking regulatory reforms. In the Committee's view, excessive regulation of U.S. banks is the most significant deterrent to U.S. economic growth.

We also note that many of our regulatory recommendations are consistent with provisions of the Financial CHOICE Act of 2017 ("**CHOICE 2.0**"), which was introduced in the House of Representatives in late April.<sup>2</sup>

A summary of our recommendations is set forth on the following two pages. Detailed analysis follows.

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<sup>1</sup> Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017).

<sup>2</sup> See Financial CHOICE Act of 2017, H.R. 10, 115th Cong. (2017).

**ROADMAP FOR REGULATORY REFORM**

- I. Conduct a Cumulative Assessment of Regulatory Impact.***
- The assessment should include a *quantitative* analysis of the *macroeconomic* effects of regulation.
  - The Treasury Department should lead the assessment, potentially with guidance from an advisory committee of bipartisan experts.
  - The assessment should *not* be a prerequisite for reform of existing regulations where problems are evident.
  - The assessment should provide the public with an opportunity for comment.
  - Independent agencies should voluntarily conduct on-going cost-benefit analyses.
- II. Enhance the U.S. Approach to International Regulatory Frameworks.***
- U.S. regulators should provide the U.S. public with an opportunity to comment on international standards to ensure that they adequately reflect U.S. interests.
  - When U.S. regulators agree to international standards, U.S. adoption should not exceed international standards unless there is a clear empirical basis for doing so.
  - U.S. regulators should not implement duplicative regulations on U.S. entities operating in foreign jurisdictions or to foreign entities operating in the United States.
  - U.S. regulators should not “ring-fence” assets of foreign financial institutions, because doing so could ultimately *increase* risk to the U.S. financial system.
- III. Reexamine Bank Capital and Liquidity Requirements.***
- Bank regulators should prioritize risk-based capital requirements and the leverage ratio should act as a backstop.
  - Bank regulators should eliminate duplicative capital requirements and create a rationalized framework.
  - Bank regulators should review and potentially eliminate or recalibrate liquidity requirements, because liquidity requirements can *increase* stress during a crisis.
  - Bank regulators should revise “operational risk” capital requirements so that they are based on banks’ *current* activities and risks.
- IV. Reduce Undue Regulatory Burdens on Community Banks and Regional Banks.***
- Bank regulators should tailor the application of Dodd-Frank prudential standards to ease regulatory burdens on smaller banks.
  - Bank regulators should reduce community bank call report burdens.
  - The CFPB should evaluate the impact of deeming mortgage loans held in a bank’s portfolio as “qualified mortgages.”
- V. Simplify and Streamline the Volcker Rule.***
- The SEC, CFTC and bank regulators should better align the Volcker Rule with the statutory prohibition.

**VI. *Ensure that Rulemakings are Adopted Through a Transparent and Public Process.***

- The Federal Reserve's stress tests and the Federal Reserve and FDIC's living wills have been adopted in a secretive manner. The Federal Reserve and FDIC must immediately adopt a more transparent process.

**VII. *Enhance the Process for Identifying and Addressing Systemic Risk.***

- The FSOC should replace non-bank SIFI designation with an activities-based regulatory framework to more effectively identify and reduce systemic risk.
- The FSOC should rescind its non-bank SIFI designations.
- The FSOC should encourage U.S. regulators with overlapping authorities to harmonize their regulations.
- The FSOC should not apply rules for banks to non-bank financial institutions.

**VIII. *Establish a Rule of Law Framework for the Federal Reserve as the Lender of Last Resort.***

- The Federal Reserve should publish a detailed framework that outlines the procedures it would use to provide effective emergency liquidity to the U.S. financial system in a crisis.

**IX. *Reinvigorate the Stagnant U.S. IPO Markets.***

- The SEC should allow shareholders through ballot propositions to adopt a mandatory system of individual arbitration to replace securities class action litigation.
- The SEC should form a working group of private companies and venture investors to assess whether regulatory reform could reinvigorate U.S. IPO markets.

**X. *Reform Trading Rules for the U.S. Stock Market.***

- The SEC should require exchanges to publicly disclose market data revenue and data feed performance information.
- The SEC should supplement its cost-benefit analysis of the consolidated audit trail with a specific analysis of the potential costs of a cyber-security breach.

**XI. *Review the U.S. Public Enforcement Regime.***

- U.S. regulators should consider the findings of the Committee's forthcoming report on the U.S. public enforcement regime.

## *I. Conduct a Cumulative Assessment of Regulatory Impact.*

We believe that an empirical assessment of the overall impact of existing laws and rules on the U.S. financial system should be a top priority for U.S. regulators and should be completed quickly.<sup>3</sup> This would be the first comprehensive analysis of the post-2008 financial crisis regulatory regime and could be used to inform regulatory and legislative priorities going forward. The need for a cumulative assessment is underscored by the fact that virtually none of the banking regulators conducted cost-benefit analyses as part of their Dodd-Frank rulemakings.<sup>4</sup> Similarly, the SEC and CFTC cost-benefit analyses for Dodd-Frank rulemakings were not quantitative, although the quality of their analyses generally improved over time.<sup>5</sup>

Below we describe four key substantive aspects of the cumulative assessment and set forth a fifth recommendation to ensure that a rigorous empirical approach to financial regulation will continue *after* the cumulative assessment is complete.

- **The assessment should include a *quantitative* analysis of the *macroeconomic* effects of regulation.**

The Committee's 2013 report, *A Balanced Approach to Cost-Benefit Analysis Reform*,<sup>6</sup> sets forth the substantive aspects of an effective cost-benefit analysis regime and provides a useful guide for ensuring that the cumulative assessment is effective.

First, the cumulative assessment should *quantify* the impact of regulations to the extent feasible. Second, the cumulative assessment should focus on the *macroeconomic* effects of regulations, including specifically the impact on economic growth, rather than firm- or industry-specific compliance costs. Third, the analysis should focus on the *overall* costs and benefits of the existing regulatory regime, rather than an individual rule-by-rule assessment. This should include a consideration of how various regulations work together and whether there are any duplicative or conflicting requirements.

- **The Treasury Department should lead the assessment, potentially with guidance from an advisory committee of bipartisan experts.**

The team leading the cumulative assessment must have ready access to the internal and external analytical expertise necessary to conduct this comprehensive analysis. They should

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<sup>3</sup> Agency officials have also highlighted the importance of such a review. *See, e.g.* Michael S. Piwowar, Comm'r, Sec. & Exch. Comm'n, Remarks at 2016 Conference on Auditing and Capital Markets (Oct. 21, 2016); Michael S. Piwowar, Comm'r, Sec. & Exch. Comm'n, Remarks at the 'SEC Speaks' Conference 2015: A Fair, Orderly, and Efficient SEC (Feb. 20, 2015); Michael S. Piwowar, Comm'r, Sec. & Exch. Comm'n, Advancing and Defending the SEC's Core Mission (Jan. 27, 2014).

<sup>4</sup> Comm. on Capital Mkts. Regulation, *A Balanced Approach to Cost-Benefit Analysis Reform* 10, Appendix A (2013), <http://www.capmksreg.org/wp-content/uploads/2013/10/A-Balanced-Approach-to-Cost-Benefit-Analysis-Reform.pdf>.

<sup>5</sup> *Id.* at 6, 8, 9.

<sup>6</sup> *Id.*



frequently consult with the financial regulatory agencies<sup>7</sup> that implemented the regulations and professionals in the financial services sector. In our view, the Treasury Department is the agency that is best situated to lead this effort, potentially with guidance from an outside advisory committee of bipartisan experts. When Secretary Paulson became Secretary of the Treasury in 2006, he publicly invited the Committee to author a report on how to restore the competitiveness of our capital markets.<sup>8</sup> The Committee stands willing to do a similar, more expansive report on regulatory reform.

- **The assessment should not be a prerequisite for reform of existing regulations where problems are evident.**

Where needed revisions to the post-crisis regime are clear, agencies should work to implement them promptly. Rather than delaying these reforms, the cumulative assessment should proceed expeditiously alongside them to complement the agency rulemaking process.

We believe that proposed rules that have not yet been finalized should generally be halted until the cumulative assessment is complete. This will ensure that any future reforms have a sound empirical basis. However, regulators should retain discretion to complete critical reforms that represent key missing pieces of existing regulatory frameworks.

- **The assessment should provide the public with an opportunity for comment.**

Public disclosure and input will enhance the quality of the cumulative review and will promote government accountability and public confidence in the assessment's findings. This aspect of the assessment would resemble the European Commission's "call for evidence" from the public regarding the EU financial services regulatory framework.<sup>9</sup>

- **Independent agencies should voluntarily conduct on-going cost-benefit analyses.**

The Committee believes that financial regulatory agencies that are not subject to a cost-benefit analysis requirement should voluntarily include a cost-benefit analysis in future rulemaking proposals. We also believe that *all* financial regulatory agencies should voluntarily conduct a reassessment five years after the implementation of any new major rule.<sup>10</sup>

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<sup>7</sup> These agencies include the Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Commodity Futures Trading Commission, Securities and Exchange Commission and Financial Stability Oversight Council, among others.

<sup>8</sup> Comm. on Capital Mkts. Regulation, *Interim Report of the Committee on Capital Markets Regulation* (Nov. 30, 2006), <http://www.capmktreg.org/wp-content/uploads/2016/10/Committees-November-2006-Interim-Report.pdf>.

<sup>9</sup> See European Comm'n, *Call for evidence: EU Regulatory Framework for Financial Services*, at 4, [http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/consultation-document\\_en.pdf](http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/consultation-document_en.pdf).

<sup>10</sup> See generally Comm. on Capital Mkts. Regulation, *A Balanced Approach to Cost-Benefit Analysis Reform* (2013), <http://www.capmktreg.org/wp-content/uploads/2013/10/A-Balanced-Approach-to-Cost-Benefit-Analysis-Reform.pdf>.

## II. *Enhance the U.S. Approach to International Regulatory Frameworks.*

Financial markets are global in nature, so effective regulation often requires coordination among regulators from different countries. Such coordination may take the form of international standards that lay the predicate for U.S. regulations. For example, U.S. agency rulemakings regarding bank capital and liquidity requirements and the designation of systemically important financial institutions are often based on standards set by international bodies. These international bodies include the Basel Committee on Banking Supervision, Financial Stability Board, International Organization of Securities Commissions, and Committee on Payments and Market Infrastructures (together, the “**International Standard Setters**”).

As a separate but related matter, U.S. regulators must determine the appropriate circumstances for applying U.S. regulations to foreign entities operating in the United States or to U.S. entities operating in foreign jurisdictions. In instances where both U.S. rules and foreign rules apply, there is a risk that conflicts or overlaps among regulatory regimes could prevent mutually beneficial cross-border transactions and lead to market fragmentation. Coordination and mutual recognition are necessary to mitigate these consequences.

Below we describe five key ways that U.S. regulators can enhance the existing regulatory landscape.

- **U.S. regulators should provide the U.S. public with an opportunity to comment on international standards to ensure that they adequately reflect U.S. interests.**

U.S. regulators should provide expanded opportunities for public comment to ensure that international standards comport with U.S. interests. Although the International Standard Setters solicit public comments on their proposals, their processes are less rigorous than the notice-and-comment process required for U.S. agency rulemaking by the Administrative Procedure Act.<sup>11</sup> For example, final rules in the United States cannot include significant restrictions that were not included in the initial proposal, because the public would not have had the opportunity to comment on these new restrictions. In contrast, the International Standard Setters’ final rules sometimes include provisions that were never subject to public consultation.<sup>12</sup>

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<sup>11</sup> For example, the Financial Stability Board charter states that the Board “should have a structured process on public consultation on policy proposals” and their procedural guidelines establish a process that “should” be adopted, *if* the plenary decides to conduct a public consultation. The process involves: (1) an invitation for comment; (2) a 30+ day consultation period (except in “exceptional circumstances”); and (3) publication of comments within 15 days of the consultation period’s end, unless otherwise requested. Fin. Stability Bd., Charter of the Financial Stability Board § I, Art. 3 (June 2012), <http://www.fsb.org/wp-content/uploads/FSB-Charter-with-revised-Annex-FINAL.pdf>; Fin. Stability Bd., FSB Procedural Guidelines § I.82 (Feb. 1, 2013), <http://www.fsb.org/wp-content/uploads/FSB-Procedural-Guidelines-31.1.13.pdf>.

<sup>12</sup> The BCBS’s final “net stable funding ratio,” for instance, included a 20% charge on derivatives liabilities that was absent from its initial proposal. Basel Comm. on Banking Supervision, *Basel III: the net stable funding ratio* (Oct. 2014), <http://www.bis.org/bcbs/publ/d295.pdf>; Basel Comm. on Banking Supervision, *Consultative Document, Basel III: The Net Stable Funding Ratio* (Jan. 2014), <http://www.bis.org/publ/bcbs271.pdf>.

Of course, the public comment processes of the International Standard Setters also do not focus specifically on the U.S. perspective.<sup>13</sup> Yet specific consideration of the U.S. perspective is critical because U.S. circumstances and needs often diverge from those in other countries. For example, U.S. and E.U. banks often have fundamental differences in their ownership and capital structures, demanding distinct regulatory approaches.

We recommend that U.S. agencies seek public comment on international standards while they are being negotiated and well before they are adopted domestically. This could take the form of U.S. regulators issuing an advanced notice of proposed rulemaking when international standards are proposed or even during earlier stages of negotiation. Doing so would provide the American public with an opportunity to potentially influence the content of international standards. We note that Section 371 of CHOICE 2.0 is consistent with this recommendation.<sup>14</sup>

- **When U.S. regulators agree to international standards, U.S. adoption should not exceed international standards unless there is a clear empirical basis for doing so.**

In recent years, U.S. agencies have agreed to international standards but then implemented domestic rules that exceed these standards, with virtually no explanation or empirical support for doing so. For example, the U.S. enhanced supplementary leverage ratio requires the largest U.S. banks to hold 6% Tier 1 capital against their total assets, while the international Basel framework requires 3%, even for the largest banks.<sup>15</sup> Similarly, the capital surcharge on the largest U.S. banks can be as high as 4.5% of risk-weighted assets, instead of up to 2.5% under the Basel framework.<sup>16</sup> The U.S. liquidity coverage ratio is also stricter than the Basel framework.<sup>17</sup>

Exceeding international standards can have significant negative implications for the United States—for example, the unilateral application of more onerous requirements on U.S. institutions puts them at a competitive disadvantage to foreign institutions. We therefore recommend that U.S.

<sup>13</sup> See, e.g., Fin. Stability Bd., *Consultative Document: Cross-border Recognition of Resolution Action* (September 29, 2014), available at: [http://www.fsb.org/2014/09/c\\_140929/](http://www.fsb.org/2014/09/c_140929/); Fin. Stability Bd., *Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities* (June 22, 2016), available at: <http://www.fsb.org/2016/06/proposed-policy-recommendations-to-address-structural-vulnerabilities-from-asset-management-activities/>.

<sup>14</sup> See Financial CHOICE Act, H.R. 10, 115th Cong. § 371 (2017).

<sup>15</sup> See Comm. on Capital Mkts. Regulation, Comment Letter to Robert de V. Frierson, Secretary, Board of Governors of the Federal Reserve System 2 (June 11, 2014), [http://www.capmktreg.org/wp-content/uploads/2014/06/CCMR.supp\\_leverage.comment-1.pdf](http://www.capmktreg.org/wp-content/uploads/2014/06/CCMR.supp_leverage.comment-1.pdf); Regulatory Capital, Revisions to the Supplementary Leverage Ratio, 79 Fed. Reg. 57725, 57726 (Sept. 26, 2014), available at <https://www.gpo.gov/fdsys/pkg/FR-2014-09-26/pdf/2014-22083.pdf>.

<sup>16</sup> See Comm. on Capital Mkts. Regulation, Comment Letter to Secretary of Board of Governors of the Federal Reserve System 4 (Apr. 1, 2015), [http://www.capmktreg.org/wp-content/uploads/2015/04/04\\_01\\_15\\_G-SIB\\_capital\\_surcharge\\_letter.pdf](http://www.capmktreg.org/wp-content/uploads/2015/04/04_01_15_G-SIB_capital_surcharge_letter.pdf); Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies, 80 Fed. Reg. 49082, 49087 (Aug. 14, 2015), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-08-14/pdf/2015-18702.pdf>; see also Sullivan & Cromwell, *Bank Capital Requirements: Federal Reserve Board Approves Final Common Equity Surcharge for U.S. Global Systemically Important Banks 2* (July 29, 2015), [https://www.sullcrom.com/siteFiles/Publications/SC\\_Publication\\_Bank\\_Capital\\_Requirements\\_7\\_29\\_2015.pdf](https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Bank_Capital_Requirements_7_29_2015.pdf).

<sup>17</sup> See Davis Polk, *U.S. Basel III Liquidity Coverage Ratio Final Rule* (Sept. 23, 2014), <http://usbase13.com/docs/Final%20LCR%20Visual%20Memo.pdf>.

agencies provide cogent explanations and clear empirical support for any domestic rules that implement more stringent versions of international standards. If an empirical analysis does not demonstrate a need for U.S. rules to exceed international standards, then the relevant U.S. rules should be revised so that they are consistent with international standards.

- **U.S. regulators should not implement duplicative regulations on U.S. entities operating in foreign jurisdictions or on foreign entities operating in the United States.**

In recent years, U.S. regulators have taken an unduly aggressive approach to applying U.S. regulations to foreign entities that are subject to similar regulations in their home jurisdiction. This has been part of an effort to protect the U.S. financial system from problems abroad. However, this approach may encourage foreign regulators to follow the U.S. example and apply duplicative regulations to U.S. entities.

For example, in early 2016 the European Commission nearly prohibited E.U. dealers from clearing derivatives with U.S. clearinghouses.<sup>18</sup> This would have fragmented the global derivatives markets, thereby increasing the cost of hedging risk both domestically and abroad. Commentary by former Vice-President Michel Barnier of the European Commission strongly suggests that the European Commission's unwillingness to compromise regarding U.S. clearinghouses was precipitated by the CFTC's unprecedented application of U.S. derivatives rules to the European Union.<sup>19</sup>

We therefore recommend that U.S. regulators defer to the regulations of foreign jurisdictions when those foreign jurisdictions have regulations that achieve the same regulatory outcomes as those in the United States. Importantly, this outcomes-based approach would focus not on a burdensome textual analysis but on whether the regulations achieve similar goals. The insistence on specific similarity of the text of every key provision is hampering the development of liquidity in global markets. For starters, we believe that the CFTC and SEC should adopt such an approach in their cross-border application of derivatives regulations.

- **U.S. regulators should not “ring-fence” U.S. assets of foreign financial institutions, because doing so could ultimately *increase* risk to the U.S. financial system.**

In 2014, the Federal Reserve finalized its intermediate holding company (“IHC”) rule that requires certain foreign banks operating in the U.S. to establish a U.S. holding company with additional capital and liquid assets located in the United States and inaccessible to the foreign parent.<sup>20</sup> The IHC rule also requires U.S. branches of foreign banks to pre-position liquid assets in

<sup>18</sup> Hal S. Scott & John Gulliver, *New EU rate-swap rule will deal a big blow to US*, CNBC (Jan. 21, 2016), <http://www.cnbc.com/2016/01/21/new-eu-rate-swap-rule-will-deal-a-big-blow-to-us-commentary.html>.

<sup>19</sup> See Michel Barnier, *The US must not override EU regulators*, Fin. Times (June 21, 2012), <https://www.ft.com/content/46584d1e-baee-11e1-81e0-00144feabdc0>.

<sup>20</sup> See 12 C.F.R. § 252.153 (2014).

the U.S. branch.<sup>21</sup> The purpose of the IHC rule is to ensure that the U.S. financial system would be protected in the event of a foreign bank failure.<sup>22</sup>

In 2013, the Committee warned that the Federal Reserve's IHC rule could make foreign banks and the global financial system *less* stable, because the foreign parent would be unable to use capital or liquid assets located in the United States to respond to losses or a run at its foreign operations.<sup>23</sup> Furthermore, existing regulations already achieve the goal of the IHC rule by ensuring that U.S. subsidiaries of foreign banks have adequate capital.

The Committee recommended that the Federal Reserve should not require foreign banks to create and capitalize a U.S. IHC and instead work with foreign regulators to develop a cross-border resolution regime that would allow for the efficient allocation of capital within international banking organizations, while also protecting the U.S. financial system.<sup>24</sup> We further warned that the Federal Reserve's approach would likely cause regulators abroad to impose similar requirements on U.S. banks in foreign jurisdictions, which could make U.S. banks less stable.<sup>25</sup> Indeed, the Committee's research showed that during the 2008 financial crisis U.S. banks needed to shift over \$500 billion from foreign operations to respond to problems at home.<sup>26</sup>

Our prediction was correct. In November, the European Commission proposed its own IHC provision for foreign banks.<sup>27</sup> The proposal will effectively restrict the ability of U.S. banks to carry on certain business activities in the E.U., and will likely make cross-border resolution more difficult. Indeed, European regulators have called for the European Commission's IHC proposal to go even further by potentially forcing subsidiarization of international branches.<sup>28</sup> We therefore recommend that the Federal Reserve review its IHC rule to specifically consider whether it could increase risk to the U.S. financial system and, if so, to repeal that rule, while working with the E.U. to stand down from their new proposal.

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<sup>21</sup> See 12 C.F.R. § 252.157 (2014); see also 79 Fed. Reg. 17240, 17296 (Mar. 27, 2014), available at <https://www.gpo.gov/fdsys/pkg/FR-2014-03-27/pdf/2014-05699.pdf>; Comm. on Capital Mkts. Regulation, Comment Letter on Proposed Rule for Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations 5-6 (Apr. 24, 2013), [http://www.capmksreg.org/wp-content/uploads/2013/04/FRB.IHC\\_comment.ltr.pdf](http://www.capmksreg.org/wp-content/uploads/2013/04/FRB.IHC_comment.ltr.pdf).

<sup>22</sup> See Press Release, Bd. of Governors of the Fed. Reserve Sys. (Feb. 18, 2014), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20140218a.htm>.

<sup>23</sup> Comm. on Capital Mkts. Regulation, Comment Letter on Proposed Rule on Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations 6-7 (Apr. 24, 2013), [http://www.capmksreg.org/wp-content/uploads/2013/04/FRB.IHC\\_comment.ltr.pdf](http://www.capmksreg.org/wp-content/uploads/2013/04/FRB.IHC_comment.ltr.pdf).

<sup>24</sup> *Id.* at 7.

<sup>25</sup> *Id.* at 6-7.

<sup>26</sup> *Id.* at 6.

<sup>27</sup> Proposal for a Directive of the European Parliament and the Council Amending Directive 2013/36/EU (2016/0364), at 12, 23-24 (proposed Article 21b).

<sup>28</sup> See, e.g., Daniele Nouy, Chair, Supervisory Board of the ECB, Statement at Press Conference on the ECB Annual Report on Supervisory Activities 2016 (Mar. 27, 2017) ("[O]ne easy correction...[is that] the branches should be attached, should be under this intermediate holding company for third countries, so would be also part of the SSM supervision because otherwise it is far too fragmented").



## III. Reexamine Bank Capital and Liquidity Requirements.

Capital requirements and liquidity requirements are prudential measures intended to strengthen the resiliency of the U.S. banking system. Capital requirements obligate banks to hold a minimum amount of equity against their total assets and risk-weighted assets so that banks can withstand losses. Liquidity requirements obligate banks to hold a minimum amount of assets that regulators have deemed safe and liquid, including U.S. Treasuries and central bank deposits, to insulate the firms from potential bank runs. Liquidity regulation also includes reporting and resolution-based liquidity requirements.

Since the financial crisis, the emphasis on the role of capital and liquidity requirements has produced measurable changes throughout the financial industry. For example, the capital levels among the largest U.S. banks have more than doubled and their holdings of high quality liquid assets are nearly five times what they were before the crisis.<sup>29</sup> However, high capital and liquidity requirements reduce the ability of banking organizations to lend and we are therefore concerned that the existing requirements have unnecessarily restricted economic growth.

Below we describe four key recommendations regarding bank capital and liquidity requirements that would help restore economic growth without compromising financial stability.

- **Bank regulators should prioritize risk-based capital requirements and the leverage ratio should act as a backstop.**

The Committee supports the use of mandatory minimum capital requirements that are sufficiently risk-sensitive. However, we believe that a binding “leverage ratio” that does not account for the different risks of different assets is highly problematic, as it incentivizes institutions to invest in risky assets that generate high returns. Such policies can therefore encourage excessive risk-taking, which undermines the goal of financial stability.

Yet existing U.S. capital requirements include a supplementary leverage ratio that may operate as the *binding constraint* on the amount of capital that certain banks must hold.<sup>30</sup> We believe that the supplementary leverage ratio should instead be calibrated to serve as a *backstop* to the risk-weighted capital requirements that banks are separately required to satisfy. In other words,

<sup>29</sup> See The Clearing House, *The State of American Banking* 14 (Nov. 2016), [https://www.theclearinghouse.org/-/media/action%20line/documents/volume%20vii/20161201\\_state-of-american-banking-report\\_tch.pdf?la=en](https://www.theclearinghouse.org/-/media/action%20line/documents/volume%20vii/20161201_state-of-american-banking-report_tch.pdf?la=en); Randall D. Guynn, *Resiliency and Resolvability of U.S. G-SIBs: What Remains To Be Done?*, Practicing L. Inst. 3 (Dec. 16, 2015),

[http://www.davispolk.com/sites/default/files/2015\\_12\\_16\\_PLI\\_Banking\\_Law\\_Institute\\_2015\\_presentation.pdf](http://www.davispolk.com/sites/default/files/2015_12_16_PLI_Banking_Law_Institute_2015_presentation.pdf).

<sup>30</sup> See Comm. on Capital Mkts. Regulation, Comment Letter on Regulatory Capital Rules: Regulatory Capital, Proposed Revisions to the Supplementary Leverage Ratio 2 (June 11, 2014), [http://www.capmksreg.org/wp-content/uploads/2014/06/CCMR.supp\\_leverage.comment-1.pdf](http://www.capmksreg.org/wp-content/uploads/2014/06/CCMR.supp_leverage.comment-1.pdf); Comm. on Capital Mkts. Regulation, Comment Letter on Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions, to Robert de V. Frierson (Oct. 21, 2013), [https://www.federalreserve.gov/SECRS/2013/October/20131030/R-1460/R-1460\\_102113\\_111417\\_579522455781\\_1.pdf](https://www.federalreserve.gov/SECRS/2013/October/20131030/R-1460/R-1460_102113_111417_579522455781_1.pdf).

the leverage ratio should generally require less capital than risk-weighted requirements, yet should act as a floor for minimum capital requirements.

Notably, a centerpiece of proposed CHOICE 2.0 is an optional regulatory “off-ramp” for banks that maintain a leverage ratio of at least 10%.<sup>31</sup> Under the bill, banks that meet the 10% leverage requirement would be exempt from a range of regulatory obligations that include other capital and liquidity requirements, stress tests, and living wills.<sup>32</sup> As stated above, we believe that a leverage ratio should not be the binding capital constraint because it incentivizes high-risk investments. We also believe that a 10% leverage ratio, which is even higher than the existing 6% supplementary leverage ratio that applies to the largest banks, would be a significant drag on economic growth. In any event, large banking organizations have indicated that they would not take the off-ramp, leaving them exposed to burdensome regulation.<sup>33</sup>

- **Bank regulators should eliminate duplicative capital requirements and create a rationalized framework.**

The current capital requirement framework has a number of overlapping requirements that are duplicative. Much of the existing regime’s complexity and redundancy is driven by the fact that U.S. bank regulators impose seven different minimum capital requirements, often with different definitions of capital.<sup>34</sup> Furthermore, this complexity is multiplied because U.S. bank regulators use two entirely different methodologies to determine whether these minimum requirements are satisfied—the Basel approach that is based on a static balance sheet and the stress test approach that is based on a dynamic balance sheet’s response to projected losses by regulators.

Although the Committee agrees in principle that “stress tests” of bank capital are a useful prudential measure, we believe that the existing *process* is highly problematic, as set forth in detail in Part VI of the Roadmap. Additionally, we believe that the stress tests’ qualitative component for assessing the management of financial risk is arbitrary and likely unnecessary. Indeed, we note that former Federal Reserve Governor Tarullo offered support for eliminating this qualitative component for all banks.<sup>35</sup> We believe that doing so would be a positive step towards simplifying regulators’ prudential requirements for capital.

In general, the Committee believes that U.S. bank regulators should work to synthesize these disparate capital requirements into a rationalized regime that accounts for the rules’ cumulative impact and reduces unnecessary overlaps. To the extent possible, they should identify

<sup>31</sup> See Financial CHOICE Act of 2017, H.R. 10, 115<sup>th</sup> Cong. § 601 (2017).

<sup>32</sup> See Financial CHOICE Act of 2017, H.R. 10, 115<sup>th</sup> Cong. § 602 (2017).

<sup>33</sup> See, e.g., Matt Levine, *Loans, Sales and IPO Advisors*, Bloomberg (Feb. 8, 2017), <https://www.bloomberg.com/view/articles/2017-02-08/loans-sales-and-ipo-advisers> (stating that Lloyd Blankfein has said he would like to operate the bank with less capital, not more).

<sup>34</sup> Regulatory Capital Rules, 78 Fed. Reg. 62018 (Oct. 11, 2013), available at <https://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf>; Risk-based capital ratios; Leverage ratio; Supplementary leverage ratio; Capital conservation buffers; Countercyclical capital buffer; Prompt corrective action requirements; Total loss-absorbing capacity.

<sup>35</sup> See Daniel K. Tarullo, Governor, Fed. Reserve Sys., *Departing Thoughts* (Apr. 4, 2017), <https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm>.

and focus on the risk-sensitive measure that is most likely to be effective without needlessly constraining firms' capital allocation decisions.

- **Bank regulators should review and potentially eliminate or recalibrate liquidity requirements, because liquidity requirements can *increase* stress during a crisis.**

Liquidity is undeniably vital to combat financial crises, but liquidity *requirements* are new regulations that are unproven in their ability to provide the type of support needed during a crisis. In fact, liquidity requirements may increase stress during a crisis. That is because banks that could otherwise lend during widespread financial distress may be forced to hoard liquid assets to maintain compliance with these requirements. Liquidity requirements that are too restrictive can therefore undermine rather than promote financial stability.

We recommend that regulators review and potentially eliminate or recalibrate existing and proposed liquidity requirements. In particular, the review should consider whether the required levels of liquid assets remain appropriate in light of recent regulatory and market-based developments. For example, if the “net stable funding ratio” (“NSFR”) is finalized, it would require banks to maintain a funding profile that regulators consider adequate to ensure access to reliable funding over a one-year period.<sup>36</sup> However, there is limited empirical support for the NSFR levels chosen by regulators and they will become increasingly difficult for banks to meet as the Federal Reserve continues to raise rates and adjust its balance sheet.<sup>37</sup>

Additionally, the “liquidity coverage ratio” (“LCR”) requires banks to hold enough low-risk “high-quality liquid assets” to satisfy their maximum funding needs over a 30-day stress period.<sup>38</sup> Yet the leverage ratio effectively *penalizes* those banks for complying with the LCR, because the leverage ratio requires banks to hold minimum levels of capital against their assets regardless of the risk profile of those assets.<sup>39</sup> The tension between the leverage ratio and LCR, and the lack of appropriate calibration of the two, have resulted in the misallocation of capital and distortions in bank balance sheets.<sup>40</sup>

- **Bank regulators should revise “operational risk” capital requirements so that they are based on banks' *current* activities and risks.**

Banks are presently required to hold capital against “operational risk,” which generally refers to the risk of unexpected losses due to a company's internal deficiencies (*e.g.*, significant

<sup>36</sup> Basel Comm. on Banking Supervision, *Basel III: the net stable funding ratio* 2 (Oct. 2014), <http://www.bis.org/bcbs/publ/d295.pdf>. Net Stable Funding Ratio: Liquidity Risk Measure Standards and Disclosure Requirements, 81 Fed. Reg. 35,123 (2016) (to be codified 12 C.F.R. § 249 *et seq.*), available at <https://www.federalreserve.gov/newsevents/press/bcreg/bcreg20160503a1.pdf>. The U.S. banking agencies published a notice of proposed rulemaking for the NSFR in May 2016. The comment period expired on August 5, 2016.

<sup>37</sup> See The Clearing House, *The Net Stable Funding Ratio: Neither Necessary nor Harmless* 2,10 (July 2016), [https://www.theclearinghouse.org/-/media/tch/documents/20160705\\_tch\\_nsfr\\_note.pdf?la=en](https://www.theclearinghouse.org/-/media/tch/documents/20160705_tch_nsfr_note.pdf?la=en)

<sup>38</sup> See The Clearing House, *The State of American Banking* 14, 30 (Nov. 2016), [https://www.theclearinghouse.org/-/media/action%20line/documents/volume%20vii/20161201\\_state-of-american-banking-report\\_tch.pdf?la=en](https://www.theclearinghouse.org/-/media/action%20line/documents/volume%20vii/20161201_state-of-american-banking-report_tch.pdf?la=en)

<sup>39</sup> See *id.* at 29-33.

<sup>40</sup> *Id.* at 7.



employee errors or technological failures) or external events (*e.g.*, lawsuits).<sup>41</sup> These capital requirements have a significant impact, as U.S. banks currently hold about \$200 billion in operational risk capital.<sup>42</sup>

However, regulators presently use models based on historical data to determine banks' operational risk requirements. As a result, banks may be required to hold operational risk capital to account for activities and liabilities that are no longer relevant to their businesses. For example, certain banks currently hold operational risk capital against business lines that they no longer pursue and legal liabilities that they have already settled.<sup>43</sup>

The Committee believes that U.S. bank regulators should revise operational risk requirements so that they are tied to banks' *current* activities and risks. The requirements should be calibrated according to realistic loss projections, not anomalous past events. We note that Section 152 of CHOICE 2.0 is consistent with this approach.<sup>44</sup>

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<sup>41</sup> See, *e.g.*, Mark Ames, Til Schuermann & Hal S. Scott, *Bank Capital for Operational Risk: A Tale of Fragility and Instability* 8 J. Risk Mgmt. Fin. Inst. 227 (2015); European Banking Auth., *Operational Risk*, <https://www.eba.europa.eu/regulation-and-policy/operational-risk> (last visited May 11, 2017).

<sup>42</sup> See Letter from Jamie Dimon, Chairman & CEO, J.P. Morgan, to Shareholders 23 (2017), <https://www.jpmorganchase.com/corporate/investor-relations/document/ar2016-ceolettersshareholders.pdf>.

<sup>43</sup> See Telis Demos, *The 93 Words that could Unlock \$200 billion in Bank Capital*, Wall St. J. (Apr. 30, 2017), <https://www.wsj.com/articles/the-93-words-that-could-unlock-more-than-200-billion-in-trapped-bank-capital-1493553602>.

<sup>44</sup> Financial CHOICE Act of 2017, H.R. 10, 115th Cong. § 152 (2017).

**IV. Reduce Undue Regulatory Burdens on Community Banks and Regional Banks.**

U.S. community and regional banks, along with large banks, have been subject to a panoply of post-crisis regulations, particularly under Dodd-Frank. Compliance with new regulations is even more difficult for these smaller institutions, because they have limited resources. New and complex rules can thus drive smaller banks from certain lines of business or otherwise constrain their ability to extend credit to the small businesses and U.S. households that rely on them. These rules can also hinder or deter new entrants. Such effects are quite undesirable due to the central role that these banks play in the U.S. economy: each year, community banks extend \$2.6 trillion in agricultural, small business, and consumer loans and regional banks lend over \$1.7 trillion to their local communities.<sup>45</sup>

Below we describe three key recommendations to reduce excessive regulatory requirements on smaller banks.

- **Bank regulators should tailor the application of Dodd-Frank prudential standards to ease regulatory burdens on smaller banks.**

Dodd-Frank §165 requires the Federal Reserve to subject bank holding companies with \$50 billion or more in assets to heightened regulation that includes stress testing, leverage and risk-based capital requirements, living wills and liquidity requirements.<sup>46</sup> There are about 40 banks that meet this threshold.<sup>47</sup> In addition, certain stress testing requirements are triggered at \$10 billion. We do not believe that all banks over these thresholds are systemically important.

We would support legislative measures to substantially raise these thresholds. However, Dodd-Frank also provides the Federal Reserve with ample flexibility to relieve smaller banks of certain of these regulatory requirements, without statutory change.

We believe that the Federal Reserve and FSOC should *increase* the \$50 billion threshold to at least \$100 billion where permitted by §165. Dodd-Frank provides that the Federal Reserve, acting upon a recommendation from FSOC,<sup>48</sup> may establish a threshold *above* \$50 billion for the application of certain heightened standards under §165.<sup>49</sup> Living wills and enhanced public disclosures are among the standards covered by this provision.<sup>50</sup>

We also commend recent efforts by the Federal Reserve to tailor prudential standards—in January 2017, the Federal Reserve finalized a rule that exempts certain banks with less than \$250

<sup>45</sup> *About the Regional Bank Coalition*, Reg'l Bank Coal., <http://regionalbanks.org/about/>; Indep. Cmty. Bankers of Am., Plan for Prosperity 12 (2017), <http://www.icba.org/docs/default-source/icba/advocacy-documents/priorities/icbaplanforprosperity>.

<sup>46</sup> See 12 U.S.C. § 5365(a)(2)(A) (2012).

<sup>47</sup> *Holding Companies with Assets Greater Than \$10 Billion*, Nat'l Info. Ctr. (last visited May 11, 2017), <https://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx>; *Biggest U.S. Banks by Asset Size 2017*, Money Summit (Feb. 9, 2017, 4:33 PM), <https://www.mx.com/moneysummit/biggest-banks-by-asset-size-united-states>.

<sup>48</sup> As set forth in 12 U.S.C. § 5325 (2012).

<sup>49</sup> 12 U.S.C. 5365(a)(2)(B) (2012).

<sup>50</sup> See *id.*

billion in assets from the qualitative portion of the annual stress tests.<sup>51</sup> We believe this change is a step in the right direction and encourage the Federal Reserve and FSOC to consider additional revisions to regulations under §165 that would mitigate burdens on smaller banks.

- **Bank regulators should reduce community bank call report burdens.**

Bank regulators<sup>52</sup> should also ease smaller bank supervision and examination requirements by streamlining their call report obligations. In recent years, quarterly call report requirements have imposed heavy costs on smaller banks that exceed their usefulness.<sup>53</sup> Small firms have been dedicating significant resources four times each year to submit the 85-page call report, containing 2,400 data items and accompanied by a 720-page instruction book.<sup>54</sup>

Regulators have made recent progress on this front by permitting U.S. banks with less than \$1 billion in assets to file the new “FFIEC 051” call report in lieu of more extensive quarterly reporting.<sup>55</sup> FFIEC 051 includes common-sense updates that consolidate and streamline aspects of the call report, shaving off 24 pages and eliminating about 950 data items.<sup>56</sup> While this reform represents progress, it does not go far enough in scaling back the unnecessary reporting obligations borne by our smallest banks.

To reduce these burdens without compromising systemic stability, community banks that meet certain safety and soundness baselines should be permitted to file simple “short-form” call reports every other quarter.<sup>57</sup> So long as the short-form call report includes essential information such as balance sheet and capital schedules, regulators should have adequate information to confirm that a small bank does not pose meaningful risk.<sup>58</sup>

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<sup>51</sup> Bd of Governors of the Fed. Reserve Sys., *Federal Reserve Board announces finalized stress testing rules removing noncomplex firms from qualitative aspect of CCAR effective for 2017* (Jan. 30, 2017, 4:30 PM), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20170130a.htm>. (The final rule removes the qualitative assessment of CCAR for large and noncomplex firms, which are bank holding companies and U.S. intermediate holding companies of foreign banking organizations with total consolidated assets between \$50 billion and \$250 billion, total nonbank assets of less than \$75 billion, and that are not identified as global systemically important banks (GSIBs).”).

<sup>52</sup> Specifically: the Federal Reserve Board, Office of the Comptroller of the Currency (“OCC”), Federal Deposit Insurance Corporation (“FDIC”), and the Federal Financial Institutions Examination Council (“FFIEC”).

<sup>53</sup> Indep. Cmty. Bankers of Am., *Plan for Prosperity* 15 (2017), <http://www.icba.org/docs/default-source/icba/advocacy-documents/priorities/icbaplanforprosperity>.

<sup>54</sup> FFIEC, “Joint Report to Congress: Economic Growth and Regulatory Paperwork Reduction Act,” (Mar. 2017) at 27, , available at: [https://www.ffiec.gov/pdf/2017\\_FFIEC\\_EGRPRA\\_Joint-Report\\_to\\_Congress.pdf](https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf); ICBA “Progress Continues on ICBA-Backed Call Report Relief,” (Jan 6, 2017), available at: <https://www.icba.org/news-events/news-details/2017/01/06/progress-continues-on-icba-backed-call-report-relief>

<sup>55</sup> FFIEC, “Joint Report to Congress: Economic Growth and Regulatory Paperwork Reduction Act,” (Mar. 2017) at 26-27, available at: [https://www.ffiec.gov/pdf/2017\\_FFIEC\\_EGRPRA\\_Joint-Report\\_to\\_Congress.pdf](https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf).

<sup>56</sup> *Id.*

<sup>57</sup> See Indep. Cmty. Bankers of Am., *Plan for Prosperity* 15 (2017), <http://www.icba.org/docs/default-source/icba/advocacy-documents/priorities/icbaplanforprosperity>; Roger Buerin Letter to Chair Yellen, <https://www.federalreserve.gov/foia/files/ICP201625formletters.pdf>.

<sup>58</sup> Buerin Letter to Chair Yellen, <https://www.federalreserve.gov/foia/files/ICP201625formletters.pdf>

- **The CFPB should evaluate the impact of deeming mortgage loans held in a bank’s portfolio as “qualified mortgages.”**

Dodd-Frank imposes a number of complex mortgage regulations on banks that disproportionately impact smaller firms. Indeed, 97% of respondents to a recent American Bankers Association survey reported increased mortgage-specific compliance costs; 75% have had to grow their staff to handle the new mortgage rules.<sup>59</sup> Notably, 76% of the ABA survey respondents had assets of less than \$1 billion.<sup>60</sup>

As a first step in reducing these burdens, the CFPB should consider revising “qualified mortgage” (“QM”) rules to grant a safe harbor from Dodd-Frank’s “ability-to-repay” requirements for mortgage loans that a bank both originates and holds in its portfolio.<sup>61</sup>

Dodd-Frank revises the Truth in Lending Act (“TILA”) to generally prohibit residential mortgage lending unless the lender determines that the borrower is able to repay the loan.<sup>62</sup> These “ability-to-repay” provisions impose a host of requirements on mortgage lenders; loans that meet the CFPB’s QM definition are presumed to satisfy these requirements.<sup>63</sup> However, the CFPB’s current QM definition is significantly more narrow than the law requires, and does not explicitly include mortgage loans held in portfolio. We can see why there may be an issue with bank decision making where loans are securitized. But where the bank holds the loan on its books it has clear self-interest in policing the credit risk involved.

We note that certain legislative proposals, such as Section 516 of CHOICE 2.0, would revise TILA to generally treat residential mortgage loans that a bank originates and holds on its balance sheet as QMs.<sup>64</sup> We recommend that the CFPB evaluate the potential effects of this change to the QM definition, including its impact on small banks’ compliance burdens. If appropriate, the CFPB should then revise the definition of QM to provide a safe harbor for mortgage loans that a bank originates and holds in its portfolio.

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<sup>59</sup> Am. Bankers Ass’n, *24<sup>th</sup> Annual ABA Residential Real Estate Survey Report* 41 (Mar. 2017), [http://www.aba.com/Press/Documents/2017ABAResidentialRealEstateSurveyReport.pdf#\\_ga=1.216188757.218730632.1490562983](http://www.aba.com/Press/Documents/2017ABAResidentialRealEstateSurveyReport.pdf#_ga=1.216188757.218730632.1490562983).

<sup>60</sup> Am. Bankers Ass’n, *24<sup>th</sup> Annual ABA Residential Real Estate Survey Report* 4 (Mar. 2017), [http://www.aba.com/Press/Documents/2017ABAResidentialRealEstateSurveyReport.pdf#\\_ga=1.216188757.218730632.1490562983](http://www.aba.com/Press/Documents/2017ABAResidentialRealEstateSurveyReport.pdf#_ga=1.216188757.218730632.1490562983).

<sup>61</sup> See, e.g., Rob Nichols Letter to Congress (Jan. 4, 2017), <http://www.aba.com/Advocacy/LetterstoCongress/Documents/ABA115thCongressWelcomePriorities010417.pdf>; Indep. Cmty. Bankers of Am., *Plan for Prosperity* 13 (2017), <http://www.icba.org/docs/default-source/icba/advocacy-documents/priorities/icbaplanforprosperity>.

<sup>62</sup> 15 U.S.C. § 1639b (2012).

<sup>63</sup> *Id.*

<sup>64</sup> See Financial CHOICE Act of 2017, H.R. 10, 115th Cong. (2017), available at: [https://financialservices.house.gov/uploadedfiles/hr\\_10\\_the\\_financial\\_choice\\_act.pdf](https://financialservices.house.gov/uploadedfiles/hr_10_the_financial_choice_act.pdf).

## V. *Simplify and Streamline the Volcker Rule*

Section 619 of the Dodd-Frank Act, commonly called the Volcker Rule,<sup>65</sup> is a legislative provision that is implemented through federal regulations jointly adopted by the Federal Reserve, SEC, CFTC, OCC, and FDIC (collectively, the “**Agencies**”).<sup>66</sup> The Secretary of the Treasury, acting as the Chairperson of the FSOC, is required to coordinate this rulemaking.<sup>67</sup>

The Volcker Rule is highly complex, so we proceed below by first explaining the statutory prohibition, then how the implementing regulation goes beyond what the legislation requires, and finally our recommendations for regulatory reform. We do not address whether the Volcker Rule should be legislatively repealed at this time.

### *The Statutory Prohibition*

Section 619 prohibits banking entities from two activities, subject to certain exemptions: (1) engaging in proprietary trading; and (2) acquiring or retaining an ownership interest in or sponsoring a hedge fund or private equity fund.<sup>68</sup> Banking entities include any insured depository institution, company that controls an insured depository institution, and any affiliate or subsidiary thereof.<sup>69</sup> Importantly, this includes bank holding companies and broker-dealer affiliates of banks.

Under Section 619, proprietary trading occurs when a banking entity engages as a *principal* for the banking entity’s own “trading account” in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, derivative or future, or any option on such instruments.<sup>70</sup> “Trading account” is defined to mean any account used for acquiring or taking positions principally for the purpose of selling in the “*near term*.”<sup>71</sup>

Section 619 explicitly carves out underwriting, market making and hedging as “permitted activities.”<sup>72</sup> More specifically, Section 619 generally permits trading in connection with underwriting or market making to the extent that any such activities, “*are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties.*”<sup>73</sup> “Risk-mitigating hedging activities... that are designed to reduce the specific risks to the banking entity” are also permitted activities.<sup>74</sup>

<sup>65</sup> 12 U.S.C. § 1851 (2012); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 619 [hereinafter Dodd-Frank Act], codified in Section 13 of the Bank Holding Company Act.

<sup>66</sup> Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; Final Rule, 79 Fed. Reg. 5535 (Jan. 31, 2014), available at <https://www.gpo.gov/fdsys/pkg/FR-2014-01-31/pdf/2013-31511.pdf>.

<sup>67</sup> 12 U.S.C. § 1851(b)(2) (2012).

<sup>68</sup> 12 U.S.C. § 1851(a)(1) (2012).

<sup>69</sup> 12 U.S.C. § 1851(h)(1) (2012). The definition also includes “any company... that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of any such entity.” *Id.*

<sup>70</sup> 12 U.S.C. § 1851(h)(4) (2012).

<sup>71</sup> 12 U.S.C. § 1851(h)(6) (2012).

<sup>72</sup> 12 U.S.C. § 1851(d) (2012).

<sup>73</sup> 12 U.S.C. § 1851(d)(1)(B) (2012).

<sup>74</sup> 12 U.S.C. § 1851(d)(1)(C) (2012).

## *The Volcker Rule*

In December 2013, the Agencies jointly adopted a Final Rule implementing the Volcker Rule.<sup>75</sup> The Final Rule is about 70 pages, with a roughly 900 page adopting release<sup>76</sup> and the restrictions on both fund investments and proprietary trading go beyond what Section 619 requires.

For example, the Final Rule’s definition of a trading account, which ultimately determines the activities that constitute proprietary trading, is much more inflexible, and captures traditional banking activities not intended to be so regulated in a “one-size-fits-all” manner, because it *presumes* that all of a banking entity’s purchases or sales of a financial instrument are for the *trading account* if the financial instrument is held for less than 60 days.<sup>77</sup> Although rebuttable, as a practical matter, the presumption has proven to be difficult to rebut and commercially unreasonable to apply because of the involvement of multiple Agencies, the Agencies’ views (not expressed in the Final Rule) that rebuttals are limited to narrow circumstances, and the Agencies’ expansive reading of the 60-day provision (by, e.g., including instruments that are designed to have less than a 60-day tenor, such as a T-bill or a short-term interest rate hedge, or including purchases of instruments that have less than 60 days left until maturity even if original maturity was longer).

These Agency implementation parameters, coupled with the inflexibility of the presumption, fail to take into account that many beneficial activities undertaken by a bank involve holding instruments less than 60 days. The rule therefore wrongly presumes that such trades and activities are prohibited.

The Committee believes that the Volcker Rule, as implemented, is unduly burdensome and complicated and has potentially impacted market liquidity. There are many potential revisions to the Agencies’ rulemaking that could mitigate these effects, but we recommend that the Agencies take the following approach.

- **The SEC, CFTC and bank regulators should better align the Volcker Rule with the statutory prohibition.**

First, the regulatory presumption that all trading positions held for less than sixty days are proprietary trading should be eliminated in favor of tailored, flexible and sensible approaches to specific activities (similar to safe harbors) for which the concept of “near term” may have different meanings or purposes. The 60-day presumption is an arbitrary threshold that was not included in Dodd-Frank and a one-size-fits-all threshold is not appropriate for identifying proprietary trades.

Second, the rulemaking should include clear, objective, non-exclusive, metrics-based “safe harbors” for market making, underwriting and related hedging activities. Although these activities

<sup>75</sup> Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; Final Rule, 79 Fed. Reg. 5535 (Jan. 31, 2014), available at <https://www.gpo.gov/fdsys/pkg/FR-2014-01-31/pdf/2013-31511.pdf>.

<sup>76</sup> Skadden, *The Volcker Rule: A First Look at Key Changes* (Dec. 12, 2013), <https://www.skadden.com/insights/volcker-rule-first-look-key-changes>.

<sup>77</sup> § \_\_.3(b)(2).



are exempt under the current rule, a quantitative safe harbor could alleviate the burdensome compliance programs and procedures imposed under the current rule that are difficult to administer and have increased the costs of beneficial market activity.<sup>78</sup> For example, with respect to such a safe harbor for hedging activity—an activity that generally should be encouraged in order to mitigate risk—the application of correlation analyses and burdensome documentation requirements would be eliminated if simple objective quantitative criteria could be met.

Third, with regards to the Volcker Rule’s restriction on covered funds, the regulatory provisions should be tailored to focus on entities that engage in impermissible proprietary trading and should not interfere with traditional banking activities and asset management, including long term investing alongside clients. To this end, the Agencies should simplify existing exclusions from the definition of covered funds and create new exclusions for: (a) fund vehicles that are not principally engaged<sup>79</sup> in impermissible proprietary trading; (b) family wealth vehicles; and (c) U.S. or non-U.S. public funds that are qualified to be offered to retail investors, or are listed on a securities exchange. The Agencies should also permit a separately incorporated, separately branded investment advisor to share its name or a variation thereof with the covered funds it sponsors. Finally, banking entities should be permitted to buy and sell ownership interests in covered funds for market making, underwriting, risk-management or asset-liability management purposes, without being subject to duplicative capital requirements.

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<sup>78</sup> If the trading activity satisfies the relevant metrics then the statutory requirement that market making and underwriting should meet “reasonably expected near term demand” of clients, should be presumed to be satisfied.

<sup>79</sup> The regulations should also provide a clear definition for the term “principally engaged” to facilitate compliance by covered entities.

## VI. *Ensure that Rulemakings are Adopted Through a Transparent Process.*

The Administrative Procedure Act of 1946 (the “APA”) determines the process by which all government agencies must conduct rulemaking. Rulemakings are agency actions that have binding legal effect,<sup>80</sup> are primarily concerned with policy considerations and govern the future conduct of regulated entities.<sup>81</sup> The APA requires that all rulemakings are adopted through a transparent process that is subject to meaningful public input.<sup>82</sup>

However, in recent years, certain financial regulatory agencies have circumvented the legally mandated process for rulemaking. In effect, these agencies have adopted rules in a secretive process without public participation. Two pertinent examples are the Federal Reserve stress tests and the Federal Reserve and FDIC’s living wills.

- **The Federal Reserve’s stress tests and the Federal Reserve and FDIC’s living wills have been adopted in a secretive manner. The Federal Reserve and FDIC must immediately adopt a more transparent process.**

The Federal Reserve’s stress tests are intended to measure whether a bank could maintain sufficient capital in a future economic crisis.<sup>83</sup> To conduct the tests, the Federal Reserve develops hypothetical extreme economic scenarios and financial models to project how bank capital would be affected by such scenarios. The Federal Reserve then uniformly applies these scenarios and models to all banks.<sup>84</sup> While the scenarios and models both directly affect the results of the stress tests and therefore serve as *de facto* capital constraints on banks, neither the economic scenarios nor the models are developed using the APA’s notice-and-comment procedures. In fact, the models are permanently kept secret.

The Committee released a report in September 2016 drawing attention to the possibility that the adoption of the scenarios and models without notice-and-comment could be in violation of the APA and could therefore be subject to a successful judicial challenge.<sup>85</sup> The Committee’s report also set forth specific recommendations for how to reform the stress test process so that it could withstand judicial scrutiny.<sup>86</sup> Specifically, the Committee recommended subjecting the scenarios to public comment and potentially doing the same for the secret models. We note that as

<sup>80</sup> See *Gen. Elec. Co. v. EPA*, 290 F.3d 377, 382 (D.C. Cir. 2002).

<sup>81</sup> U.S. Dep’t of Justice, Attorney General’s Manual on the Administrative Procedure Act 14-15 (1947).

<sup>82</sup> 5 U.S.C. § 552(a)(1)(D) (2012).

<sup>83</sup> Governor Daniel K. Tarullo, Member of the Bd. of Governors of the Fed. Reserve Sys., *Stress Testing After Five Years* (June 25, 2014).

<sup>84</sup> See, e.g., Beverly Hirtle & Andreas Lehnert, *Supervisory Stress Tests*, Federal Reserve Bank of New York Staff Reports, No. 696 at 18 (2014); Supervisory and Company-Run Stress Test Requirements for Covered Companies, 77 Fed. Reg. 62,378, 62,384 (Oct. 12, 2012); Bd. of Governors of the Fed. Reserve Sys., *Dodd-Frank Act Stress Test 2015: Supervisory Stress Test Methodology and Results* 7, 11 (2015).

<sup>85</sup> Comm. On Capital Mkts. Reg. “The Administrative Procedure Act and Federal Reserve Stress Tests: Enhancing Transparency,” (September 2016), available at: [http://www.capmktsreg.org/wp-content/uploads/2016/10/Final\\_APA\\_Fed\\_Stress\\_Test\\_Statement1.pdf](http://www.capmktsreg.org/wp-content/uploads/2016/10/Final_APA_Fed_Stress_Test_Statement1.pdf).

<sup>86</sup> *Id.*



part of his April 2017 departure address, former Federal Reserve Governor Tarullo indicated that he believes that the Federal Reserve should keep its stress test models secret.<sup>87</sup>

Similarly, the Federal Reserve and the FDIC have adopted uniformly applicable, secret, binding standards for determining whether a bank's living will is credible (*i.e.*, whether, in the regulators' view, a bank could be resolved without extraordinary government support).<sup>88</sup> Indeed, several banks have failed the living wills process for deficiencies under these secret standards.<sup>89</sup> Failing the living will process can result in a number of regulatory sanctions on banks. For example, Dodd-Frank provides the FDIC and Federal Reserve with the authority to break up banks that fail the living wills process.<sup>90</sup>

The Federal Reserve and FDIC have also made significant regulatory policy via *post hoc* guidance on banks' living wills. Such guidance has placed significant requirements on the living will process, and resulted in restrictions on activities and structures of banks, all without notice-and-comment under the APA. For example, they have directed banks to hold levels of liquid assets that meet peak standalone funding needs for each of their material entities.<sup>91</sup> This requirement may effectively act as the binding constraint on mandatory bank liquidity levels.<sup>92</sup>

The Committee believes that circumventing the APA's procedural requirements is bad public policy.<sup>93</sup> Without information about the standards being applied by agencies, markets cannot make informed decisions about the integrity of the government's conclusions, such as whether a bank could truly be resolved in an orderly fashion.<sup>94</sup> Additionally, when agencies develop rules that are not made available to the public, the danger for unequal and inconsistent treatment of similarly situated institutions exists.<sup>95</sup> And when rules are not developed openly, it is more difficult to hold public officials accountable for their actions and to ensure that they are acting with an open mind.<sup>96</sup>

<sup>87</sup> See Daniel K. Tarullo, Governor Bd. of Governors of the Fed. Reserve Sys., *Departing Thoughts* (Apr. 4, 2017), <https://www.federalreserve.gov/newsevents/speech/tarullo20170404a.htm>.

<sup>88</sup> Hal S. Scott, *Op-Ed: Publish the Secret Rules for Banks' Living Wills*, Wall St. J. (June 10, 2016), <http://www.wsj.com/articles/publish-the-secret-rules-for-banks-living-wills-1465511622>.

<sup>89</sup> *Id.*; See also Bd. of Governors of the Fed. Reserve Sys. Fed. Deposit Ins. Corp. Joint Press Release, *Agencies Announce Determinations on October Resolution Plan Submissions of Five Systemically Important Domestic Banking Institutions* (Dec. 13, 2016), <https://www.federalreserve.gov/newsevents/press/bcreg/20161213a.htm>.

<sup>90</sup> See 12 U.S.C. § 5365 (2012).

<sup>91</sup> The Clearing House, *The State of American Banking* 40 (Nov. 2016), [https://www.theclearinghouse.org/-/media/action%20line/documents/volume%20vii/20161201\\_state-of-american-banking-report\\_tch.pdf?la=en](https://www.theclearinghouse.org/-/media/action%20line/documents/volume%20vii/20161201_state-of-american-banking-report_tch.pdf?la=en).

<sup>92</sup> See *id.*

<sup>93</sup> See Comm. on Capital Mkts. Regulation, *The Administrative Procedure Act and Federal Reserve Stress Tests: Enhancing Transparency* (Sept. 2016), [http://www.capmktreg.org/wp-content/uploads/2016/10/Final\\_APA\\_Fed\\_Stress\\_Test\\_Statement1.pdf](http://www.capmktreg.org/wp-content/uploads/2016/10/Final_APA_Fed_Stress_Test_Statement1.pdf).

<sup>94</sup> *Id.*

<sup>95</sup> Cf. U.S. Dep't of Justice, Attorney General's Manual on the Administrative Procedure Act 5 (1947) (stating that one of the aims of the APA is to "achieve relative uniformity in the administrative machinery of the federal government").

<sup>96</sup> See *Riverbed Farms, Inc. v. Madigan*, 958 F.2d 1479, 1484 (9th Cir. 1992) (the APA "ensures that the massive federal bureaucracy remain[s] tethered to those it governs"); Cary Coglianese et al., *Presidential Transition Task*

Furthermore, the APA’s notice-and-comment process allows the public to provide valuable insights and information to agencies that promote quality decision-making.<sup>97</sup> An opaque rulemaking process also creates legal uncertainty, as agency actions may be overturned by the federal courts as unlawful. Indeed, the APA allows any individual or entity adversely affected by an agency action to challenge the agency action in federal court<sup>98</sup> and a federal court is authorized to set aside any agency action that fails to follow the APA.<sup>99</sup>

In short, the Trump Administration should ensure that the financial regulatory agencies comply with the APA. Specifically, the Federal Reserve should conduct publicly-available rulemakings for its stress test scenarios and models and the Federal Reserve and FDIC should do the same for the standards governing the review of and expectations for living wills.

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*Force, Transparency and Public Participation in the Rulemaking Process*, Faculty Scholarship (2008) (stating the public participation “ensure[s] that agencies and their staffs act fairly, approaching regulatory problems with an open mind and listening respectfully to a broad spectrum of public perspectives”).

<sup>97</sup> See Connor Raso, *Agency Avoidance of Rulemaking Procedures*, 67 Admin. L. Rev. 101, 103 (2015); Cary Coglianese et al., Presidential Transition Task Force, *Transparency and Public Participation in the Rulemaking Process*, Faculty Scholarship (2008).

<sup>98</sup> 5 U.S.C. §§ 702, 704.

<sup>99</sup> 5 U.S.C. § 706(2).

## VII. *Enhance the Process for Identifying and Addressing Systemic Risk.*

A critical purpose of the Dodd-Frank Act is to enhance regulators' ability to identify and address systemic risk. To assist in this effort, Dodd-Frank created the Financial Stability Oversight Council ("FSOC"), which is comprised of the Secretary of the Treasury, the heads of eight regulatory agencies, and an independent insurance expert.<sup>100</sup>

Specifically, the FSOC has the authority to designate certain non-bank financial institutions as "systemically important financial institutions" ("SIFIs"), subjecting them to enhanced oversight and regulation by the Federal Reserve. The FSOC also has the authority to identify and recommend agency actions to address products and activities that may pose systemic risk.<sup>101</sup>

President Trump recently issued an Executive Order in the form of a Memorandum to the Secretary of the Treasury effectively suspending the FSOC's authority to designate any new non-bank financial institutions as SIFIs until the Secretary has conducted a thorough review of the FSOC determination and designation process.<sup>102</sup> The Secretary's report is due on October 18, 2017.

Below we set forth four recommendations for the FSOC that would enhance financial stability and encourage U.S. economic growth.<sup>103</sup>

- **The FSOC should replace non-bank SIFI designation with an activities-based regulatory framework to more effectively identify and reduce systemic risk.**

The stated goal of SIFI designation is to identify and mitigate sources of systemic risk, but systemic risk cannot be ascribed to specific institutions. On the contrary, the Committee believes that effectively monitoring and reducing systemic risk requires regulators to focus on any activities and products that have been empirically linked to systemic risk.<sup>104</sup> Accordingly, we find the post-crisis reforms that take an activities-based approach, such as reforms to the swaps market, to be the most effective at mitigating systemic risk. Indeed, the FSOC has already adopted such an

<sup>100</sup> Voting members of FSOC include the heads of the CFPB, CFTC, FDIC, Federal Reserve, FHFA, NCUA, OCC and SEC.

<sup>101</sup> See 12 U.S.C. § 5322(a)(2) (2012); 12 U.S.C. § 5323 (2012).

<sup>102</sup> Office of the Press Sec'y, Press Release, *Presidential Memorandum for the Secretary* (Apr. 21, 2017), <https://www.whitehouse.gov/the-press-office/2017/04/21/presidential-memorandum-secretary-treasury>.

<sup>103</sup> It is worth noting that our recommendations regarding non-bank SIFI designation are similar to certain provisions of CHOICE 2.0 that would repeal the FSOC's authority to issue non-bank SIFI determinations.

<sup>104</sup> See, e.g., Comm. on Capital Mkts. Regulation, Comment Letter to FSOC, U.S. Treasury Dep't (Mar. 16, 2015), [http://www.capmksreg.org/wp-content/uploads/2015/03/2015\\_03\\_16\\_FSOC\\_Notice\\_on\\_Asset\\_Management\\_Products\\_Activities.pdf](http://www.capmksreg.org/wp-content/uploads/2015/03/2015_03_16_FSOC_Notice_on_Asset_Management_Products_Activities.pdf); Comm. on Capital Mkts. Regulation, Comment Letter to Secretariat, Financial Stability Board (Apr. 7, 2014), [http://www.capmksreg.org/wp-content/uploads/2014/04/FSB.IOSCO\\_comment.ltr.pdf](http://www.capmksreg.org/wp-content/uploads/2014/04/FSB.IOSCO_comment.ltr.pdf); Comm. on Capital Mkts. Regulation, Comment Letter to Neal S. Wolin, Acting Chairman, FSOC, U.S. Treasury Dep't (Feb. 15, 2013), [http://www.capmksreg.org/wp-content/uploads/2013/02/FSOC.non-bank.SIFI\\_comment.ltr.pdf](http://www.capmksreg.org/wp-content/uploads/2013/02/FSOC.non-bank.SIFI_comment.ltr.pdf); Comm. on Capital Mkts. Regulation, *What to Do About Contagion?* (Sept. 3, 2014), <http://www.capmksreg.org/wp-content/uploads/2016/10/2014-09-03-WDAC.pdf>.

approach for assessing the risk posed by the asset management industry.<sup>105</sup> However, we note that the FSOC only has the authority to *identify* potentially risky activity and to *recommend* policy action by primary industry regulators. It is therefore crucial that the primary regulators responsible for implementing any FSOC recommendations, such as state insurance commissioners with respect to insurers, also employ an activities-based approach.<sup>106</sup>

- **The FSOC should rescind its non-bank SIFI designations.**

The FSOC should rescind its existing non-bank SIFI designations, as systemic risk is not concentrated at traditional insurance companies. Traditional insurance companies have a number of qualities that make them unlikely to pose systemic risk. These include low levels of short-term debt, high substitutability, and self-funding with insurance premiums.<sup>107</sup> Indeed, the traditional insurance industry remained relatively stable during the financial crisis and did not show signs of systemic risk.<sup>108</sup> Furthermore, certain activities-based reforms enacted since the crisis, including those to the swaps markets, help to ensure that insurers' positions remain appropriately risk-managed and collateralized.

- **The FSOC should encourage U.S. regulators with overlapping authorities, including the SEC and CFTC over the swaps market, to harmonize their regulations.**

Inconsistencies and overlaps in domestic regulations can create unnecessary burdens on U.S. financial institutions that can ultimately increase the cost of financial services and decrease the competitiveness of our institutions and our markets. Fortunately, the Dodd-Frank Act authorizes the FSOC to encourage and even compel U.S. regulators with overlapping authorities to act in a consistent and effective manner.<sup>109</sup> Such action may be necessary to harmonize CFTC and SEC regulations for swaps and security-based swaps transactions.<sup>110</sup> Although the agencies' requirements generally apply to the same dealers and entities, the agencies have thus far failed to collaborate during their rulemaking processes and to coordinate implementation timing, and the resultant regulations are different in key respects<sup>111</sup> that increase compliance costs and create

<sup>105</sup> See, e.g., Fin. Stability Oversight Council, *Financial Stability Oversight Council Update on Review of Asset Management Products and Activities* (Apr. 2016), <https://www.treasury.gov/initiatives/fsoc/news/Documents/FSOC%20Update%20on%20Review%20of%20Asset%20Management%20Products%20and%20Activities.pdf>.

<sup>106</sup> See 12 U.S.C. § 5330 (2012) (limiting the authority to implement FSOC recommendations to primary regulators, who have 90 days to implement them or explain why they have not done so to Congress).

<sup>107</sup> See Comm. on Capital Mkts. Regulation, Comment Letter to Neal S. Wolin, Acting Chairman, FSOC, U.S. Treasury Dep't, on the Authority of the Financial Stability Oversight Council to Designate Certain Non-Bank Financial Companies (Feb. 15, 2013), [http://www.capmksreg.org/wp-content/uploads/2013/02/FSOC.non-bank.SIFI.comment.ltr\\_.pdf](http://www.capmksreg.org/wp-content/uploads/2013/02/FSOC.non-bank.SIFI.comment.ltr_.pdf); Comm. on Capital Mkts. Regulation, Comment Letter to FSOC Re: *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 76 Fed. Reg. 64,264 (Dec. 19, 2011), [http://www.capmksreg.org/2011/12/19/fsoc-comment-regarding-its-authority-to-require-supervision-and-regulation-of-certain-nonbank-financial-companies/#\\_ftn11](http://www.capmksreg.org/2011/12/19/fsoc-comment-regarding-its-authority-to-require-supervision-and-regulation-of-certain-nonbank-financial-companies/#_ftn11).

<sup>108</sup> *Id.*

<sup>109</sup> 12 U.S.C. § 5322(a)(2)(E) (2012).

<sup>110</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, 7 U.S.C. § 2(i) (2012).

<sup>111</sup> See, e.g., Comm. on Capital Mkts. Regulation, Comment Letter on Proposed Rules on SEC and CFTC Cross-Border Swaps Rules and Guidance (Aug. 17, 2013), [http://www.capmksreg.org/wp-content/uploads/2013/08/SEC.cross\\_border.ltr\\_-1.pdf](http://www.capmksreg.org/wp-content/uploads/2013/08/SEC.cross_border.ltr_-1.pdf).

confusion. The FSOC should consider mandating that agencies with overlapping authorities issue rulemakings jointly or that they reevaluate existing rules to eliminate inconsistencies or redundancies.

- **The FSOC should not apply rules for banks to non-bank financial institutions.**

Bank capital and liquidity requirements were devised to enhance the stability of depository institutions, and their mechanics and calibration are specifically designed for banks. Applying these requirements to non-banks would be unwarranted, as these institutions have different business models and asset and liability structures. Instead, the regulation of non-banks should proceed independently, according to the distinct characteristics and circumstances of these institutions.

**VIII. Establish a Rule of Law Framework for the Federal Reserve as the Lender of Last Resort.**

The Committee rejects the notion that the Federal Reserve acting as “lender of last resort” (“LLR”) to the financial system is a “bailout.” Bailouts are capital injections to *insolvent* financial institutions. The Committee is strongly opposed to bailouts.

We do, however, support the role of an LLR that stands ready to provide liquidity to the financial system in the event of a financial panic; this liquidity is provided in the form of central bank loans at a penalty rate and against good collateral to solvent financial institutions that are victims of panicked withdrawals.<sup>112</sup> Of course, these loans must be repaid.

An effective LLR promotes financial stability by both *preventing* and *stemming* runs on financial institutions. An LLR prevents mass withdrawals by short-term creditors (such as bank depositors) by reassuring them that they will be repaid in full, so there is no need to run. An LLR also stems runs by extending needed liquidity to help solvent institutions meet panicked withdrawals by short-term creditors. Indeed, the Federal Reserve stemmed the 2008 financial crisis by extending LLR support to financial institutions through credit facilities like the Term Securities Lending Facility and Primary Dealer Credit Facility.<sup>113</sup>

Perhaps most importantly, with an effective LLR, the government can let insolvent institutions fail with creditors of those institutions bearing its losses, not taxpayers. That is because an effective LLR prevents the failure of insolvent institutions from triggering a contagious panic that spreads throughout the otherwise solvent financial system.

The Dodd-Frank Act imposes major restrictions on the ability of the Federal Reserve to serve as an effective LLR to non-banks, which hold over 60% of short-term liabilities, totaling \$8 trillion.<sup>114</sup> Section 1008 of CHOICE 2.0 would further restrict the Federal Reserve’s effectiveness as an LLR to the non-bank sector by imposing additional restrictions on its ability to lend to non-banks during a crisis.<sup>115</sup> We do not support this CHOICE 2.0 provision. As Chair Yellen has testified, these new restrictions would effectively end the ability of the Federal Reserve to serve as LLR to the non-bank sector.<sup>116</sup>

<sup>112</sup> See Walter Bagehot, *Lombard Street: A Description of the Money Market* (E. Johnstone; Hartley Withers, eds., 1873); see also Comm. on Capital Mkts. Regulation, *What to do about Contagion?: A Call by the Committee on Capital Markets Regulation for Public Debate* 9-10 (Sept. 3, 2014), <http://www.capmksreg.org/wp-content/uploads/2016/10/2014-09-03-WDAC.pdf>.

<sup>113</sup> See Hal S. Scott, *Interconnectedness and Contagion*, Comm. on Capital Mkts. Regulation (Nov. 20, 2012), [http://www.capmksreg.org/wp-content/uploads/2014/11/2012.11.20\\_Interconnectedness\\_and\\_Contagion.pdf](http://www.capmksreg.org/wp-content/uploads/2014/11/2012.11.20_Interconnectedness_and_Contagion.pdf); Professor Kenneth N. Kuttner, *The Federal Reserve as Lender of Last Resort during the Panic of 2008*, Comm. on Capital Mkts. Regulation (Dec. 30, 2008), [http://www.capmksreg.org/wp-content/uploads/2015/04/Kuttner\\_The-Federal-Reserve-as-Lender-of-Last-Resort-during-the-Panic-of-2008.pdf](http://www.capmksreg.org/wp-content/uploads/2015/04/Kuttner_The-Federal-Reserve-as-Lender-of-Last-Resort-during-the-Panic-of-2008.pdf).

<sup>114</sup> Hal S. Scott, *Interconnectedness and Contagion*, Comm. on Capital Mkts. Regulation 93-108, 289 (2016), [http://www.capmksreg.org/wp-content/uploads/2014/11/2012.11.20\\_Interconnectedness\\_and\\_Contagion.pdf](http://www.capmksreg.org/wp-content/uploads/2014/11/2012.11.20_Interconnectedness_and_Contagion.pdf).

<sup>115</sup> Financial CHOICE ACT of 2017, H.R. 10, 115th Cong. § 1008 (2017).

<sup>116</sup> See Chair Janet Yellen, Letter from Janet Yellen, Chair, Federal Reserve System, to Honorable Paul Ryan & Honorable Nancy Pelosi (Nov. 16, 2015), <https://www.federalreserve.gov/foia/files/ryan-pelosi-letter-20151116.pdf>.



- **The Federal Reserve should publish a detailed framework that outlines the procedures it would use to provide effective emergency liquidity to the U.S. financial system in a crisis.**

It is essential that the Federal Reserve adopt a rule of law framework for exercising its LLR authorities effectively. A detailed outline of how the Federal Reserve would intervene as LLR in a crisis will prepare the central bank to take swift action during a crisis and ensure that it does not overstep its authority. Publishing such a framework could also forestall panics by signaling the existence of a capable LLR to the markets. Although the Federal Reserve issued a rulemaking to implement the LLR provisions of the Dodd-Frank Act, this rulemaking does not provide detail on the procedures that the Federal Reserve would use during a crisis.<sup>117</sup>

There are several key components to an effective rule of law LLR framework. First, the framework should set forth how the Federal Reserve would make its solvency determination with respect to the borrower. This would go beyond ensuring that the borrower had adequate collateral. Second, the framework should outline the specific measures that the Federal Reserve would take during a crisis to provide LLR support to both banks (via the discount window) and to non-banks (under Section 13(3) of the Federal Reserve Act). For example, the Federal Reserve should identify the specific facilities and programs that it would use to lend and the criteria that it would use to determine borrower eligibility. Finally, the framework should establish certain procedures for Federal Reserve oversight and regulation of non-bank LLR borrowers.

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<sup>117</sup> Extensions of Credit by Federal Reserve Banks, 80 Fed. Reg. 78,959 (Dec. 18, 2015), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-12-18/pdf/2015-30584.pdf>.

**IX. *Reinvigorate the Stagnant U.S. IPO Market.***

The public capital markets play a vital role in the U.S. economy, as they are the principal vehicle through which companies raise the funding necessary for growth and the principal repository for individual and institutional investment. Ultimately, the global economic leadership of the United States depends on the strength of these markets.

Ten years ago, at the request of Secretary of the Treasury Henry Paulson, the Committee released a report finding that foreign companies were no longer going public on U.S. exchanges at historical rates and foreign companies listed on U.S. exchanges were delisting at an increasing rate.<sup>118</sup> The attractiveness of U.S. public equity markets to foreign companies was clearly weakening.

Earlier this month, the Committee released a new report finding that over the past ten years the attractiveness of U.S. public equity markets to private U.S. companies has deteriorated, whereas the public equity markets of foreign countries, particularly China, have become increasingly attractive to private foreign companies.<sup>119</sup>

Specifically, the Committee's report found that over the past ten years the number of U.S. IPOs and the total amount of equity raised by them are substantially down from historical averages during the 1996-2006 period.<sup>120</sup> Historical averages predicted that there would have been over 3,000 new public companies in the last decade.<sup>121</sup> Instead, we have had *less than half* of that many IPOs.<sup>122</sup>

The Committee's study also finds that the Jumpstart our Business Startup (JOBS) Act that was enacted into law by President Obama in 2012 has failed to achieve its purpose of strengthening the U.S. IPO market. For example, in 2016 only \$24 billion in equity was raised by U.S. IPOs, as compared to a historical average of nearly \$60 billion.<sup>123</sup>

Chinese IPO markets have also caught up to and surpassed U.S. IPO markets in the last ten years. While there are surely many factors impacting the strength of Chinese markets, including higher economic growth, it is notable that more than *twice* as much equity was raised through Chinese IPOs last year than through U.S. IPOs.<sup>124</sup>

The Committee's report recommends that the SEC take two initial steps to reinvigorate U.S. public equity markets.<sup>125</sup>

<sup>118</sup> Comm. on Capital Mkts. Regulation, *The Competitive Position of the U.S. Public Equity Market* (Dec. 4, 2007), [http://www.capmktreg.org/wp-content/uploads/2014/12/The\\_Competitive\\_Position\\_of\\_the\\_US\\_Public\\_Equity\\_Market.pdf](http://www.capmktreg.org/wp-content/uploads/2014/12/The_Competitive_Position_of_the_US_Public_Equity_Market.pdf).

<sup>119</sup> Comm. on Capital Mkts. Regulation, *U.S. Public Equity Markets are Stagnating* 1 (2017), [http://www.capmktreg.org/wp-content/uploads/2017/04/US\\_Public\\_Equity\\_Markets\\_are\\_Stagnating.pdf](http://www.capmktreg.org/wp-content/uploads/2017/04/US_Public_Equity_Markets_are_Stagnating.pdf).

<sup>120</sup> *Id.* at 2.

<sup>121</sup> *Id.* at 10.

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.* at 9.



- **The SEC should allow shareholders through ballot propositions to adopt a mandatory system of individual arbitration to replace securities class action litigation.**

The United States is the only developed country in the world where shareholders of a public company can form a class and sue their own company for a violation of securities laws, primarily consisting of disclosure failures. Therefore, when private U.S. companies go public in the United States they become exposed to litigation risk from securities class actions that can cost them billions of dollars.

This is a serious problem for public companies and a major incentive to stay private. For example, in 2016 a record 300 securities class action lawsuits were filed, targeting about 1 in every 12 U.S. public companies.<sup>126</sup> The mere *filing* of such a suit has been shown to reduce a target company's market value by 10%.<sup>127</sup> And the settlements of these suits have cost public companies an additional \$55.6 billion over the past ten years.<sup>128</sup>

These suits impose staggering costs on U.S. investors and capital markets, but fail to accomplish their ostensible goals of compensating harmed investors or deterring wrongdoing. Instead, as former SEC Commissioner Paul Atkins explains, "the costs of defending and settling these suits are borne by the company's shareholders, leading to an absurd situation in which money is merely shifted from one group of innocent investors to another, with plaintiff and defense attorneys siphoning off billions of dollars in the process."<sup>129</sup>

The ineffectiveness of securities class actions in compensating shareholders is widely acknowledged and empirically demonstrated.<sup>130</sup> In these suits, institutional shareholders effectively sue themselves and bear the staggering costs of these suits, so their net recovery is negative. The aggregate U.S. settlement size in 2015 was approximately \$5 billion, roughly \$1.1 billion of which was used to pay attorneys' fees and expenses.<sup>131</sup> And the recoveries of retail shareholders are so low that the Committee has found that holders of only 40-60% of shares that are potentially eligible for distribution even submit a claim.<sup>132</sup>

Allowing shareholders to adopt a mandatory system of individual arbitration instead of securities class actions would better compensate investors and deter wrongdoing; it would also

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<sup>126</sup> *Id.* at 10.

<sup>127</sup> *Id.* at 5 (citing Mark Klock, *Do Class Action Filings Affect Stock Prices? The Stock Market Reaction to Securities Class actions Post PSLRA*, 15 J. Bus. & Sec. L. 109 (2016)).

<sup>128</sup> *Id.* at 10.

<sup>129</sup> Paul Atkins, *The Supreme Court's Opportunity to End Abusive Class Action Securities Laws*, *Forbes* (Mar. 4, 2014), <http://www.forbes.com/sites/realspin/2014/03/04/the-supreme-courts-opportunity-to-end-abusive-securities-class-action-lawsuits/#14ae89e1690a>.

<sup>130</sup> See, e.g., John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 Colum. L. Rev. 1534, 1538 (2006); James D. Cox et al., *There Are Plaintiffs and...There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 Vand. L. Rev. 355 (2008).

<sup>131</sup> Svetlana Starykh & Stefan Boettlich, *NERA Econ. Consulting, Recent Trends in Securities Class Action Litigation: 2015 Full-Year Review* 31, 37(2016), [http://www.nera.com/content/dam/nera/publications/2016/2015\\_Securities\\_Trends\\_Report\\_NERA.pdf](http://www.nera.com/content/dam/nera/publications/2016/2015_Securities_Trends_Report_NERA.pdf).

<sup>132</sup> Hal S. Scott & Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 Harv. J.L. & Pub. Pol'y 1187, 1193 (2013).

benefit the U.S. capital markets. At the corporate level, this could be achieved with a shareholder proposal in a company's proxy statement to include a vote to amend the corporate bylaws.<sup>133</sup> The by-laws amendment could include an arbitration clause that would govern issuer-stockholder securities law disputes.<sup>134</sup>

Congress and the Supreme Court have endorsed the fairness and legality of arbitration provisions.<sup>135</sup> Indeed, arbitration is used to resolve securities law disputes in other contexts (e.g., broker-customer conflicts). Shareholders would also prefer to have the option to arbitrate these claims—in fact, they have proposed such provisions in the past.<sup>136</sup> However, the SEC has arguably overstepped its statutory authority by blocking these past attempts.<sup>137</sup> We urge the agency to step aside and permit such shareholder decisions in the future.

- **The SEC should form a working group of private companies and venture investors to assess whether regulatory reform could reinvigorate U.S. IPO markets.**

The Committee's report found that U.S. private markets are booming. Private U.S. companies, including Lyft and SpaceX, are raising record amounts of equity capital in private markets. For example, the Committee's report found that private companies raised almost \$120 billion through private offerings in 2016, almost five times the equity raised through U.S. IPOs.<sup>138</sup>

While strong private markets are a good thing for economic growth, retail investors can only invest in public companies, so they need private companies, like Uber and Airbnb, to go public, or else they will miss out on potentially lucrative investment opportunities. Part of the problem may be that the SEC's one-size-fits-all disclosure regime for public companies is contributing to public markets having a "short-term" view that does not suit young and exciting private companies that must prioritize long-term growth to short-term returns.<sup>139</sup>

Ultimately, only private companies and their investors know exactly why they are avoiding public markets. The SEC should therefore go directly to the source and convene a working group of private companies and venture investors to better understand why private companies are avoiding public markets and how to fix this problem. Ideally, this group should produce a report that could then be used as the basis for significant SEC and legislative reform.

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<sup>133</sup> *Id.*

<sup>134</sup> *See id.*

<sup>135</sup> *See, e.g.*, Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* (2012); AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1749 (2011);

<sup>136</sup> *See* Pfizer Inc., SEC No-Action Letter (Feb. 22, 2012); Gannett Co., Inc., SEC No-Action Letter (Feb. 22, 2012).

<sup>137</sup> Hal S. Scott & Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 Harv. J.L. & Pub. Pol'y 1187, 1221-22 (2013).

<sup>138</sup> Comm. on Capital Mkts. Regulation, *U.S. Public Equity Markets are Stagnating* 10 (2017), [http://www.capmktreg.org/wp-content/uploads/2017/04/US\\_Public\\_Equity\\_Markets\\_are\\_Stagnating.pdf](http://www.capmktreg.org/wp-content/uploads/2017/04/US_Public_Equity_Markets_are_Stagnating.pdf).

<sup>139</sup> *Id.* at 5.

## X. *Reform Trading Rules for the U.S. Stock Market*

Well-functioning trading markets are critical to the success of the U.S. economy, because they promote the productive allocation of capital by allowing U.S. investors to efficiently enter and exit their positions and providing accurate prices for shares of U.S. companies. Indeed, equity market structure enhancements over the last 10-20 years have significantly reduced investor transaction costs, resulting in higher net returns.<sup>140</sup> For example, due to reforms by the SEC in the early 2000s, a \$10,000 investment in a mutual fund over 30 years would now earn an investor roughly \$132,000 instead of \$100,000.<sup>141</sup> However, a lack of understanding about aspects of today's markets, such as high frequency trading strategies, has fostered concerns that the markets are not functioning effectively for long-term investors.<sup>142</sup>

The Committee released a comprehensive report on U.S. equity markets in July 2016.<sup>143</sup> The report includes an empirical analysis of stock orders and trades over the past 20 years, finding that our equity markets are performing well for investors, evidenced by high levels of liquidity and record low transaction costs.<sup>144</sup> However, we also identify significant room for improvement and believe that the SEC should undertake a wholesale review of the equity market framework, particularly Regulation National Market System. The Committee's report therefore also presents 26 policy recommendations to: (1) increase transparency; (2) lower transaction costs; and (3) strengthen market resiliency.<sup>145</sup> We encourage the SEC to use the empirical findings and policy recommendations set forth in the Committee report to inform and guide its market structure agenda.

We also believe that the SEC should prioritize two key reforms in the near term.

- **The SEC should require exchanges to publicly disclose market data revenue and data feed performance information.**

Investors and their brokers rely on access to “consolidated market data,” or timely information regarding stock quotations and trade executions, to evaluate and execute investment decisions.<sup>146</sup> There are two ways to access this data: via (1) the securities information processors (“SIPs”); and (2) “proprietary data feeds.” Stock exchanges have monopoly control over both and charge for access to both.<sup>147</sup>

<sup>140</sup> See Letter from Vanguard Group, Inc. to Elizabeth M. Murphy, Secretary, Securities & Exchange Commission, Re: SEC Concept Release on Equity Market Structure (Apr. 21, 2010), <https://www.sec.gov/comments/s7-02-10/s70210-122.pdf>.

<sup>141</sup> *Id.*

<sup>142</sup> Comm. on Capital Mkts. Regulation, *The U.S. Equity Markets: A Plan for Regulatory Reform* (July 2016), [http://www.capmktreg.org/wp-content/uploads/2016/10/08\\_08\\_FINAL\\_DRAFT\\_EMS\\_REPORT-1.pdf](http://www.capmktreg.org/wp-content/uploads/2016/10/08_08_FINAL_DRAFT_EMS_REPORT-1.pdf).

<sup>143</sup> *Id.*

<sup>144</sup> *Id.*

<sup>145</sup> Three of the twenty-six Committee recommendations would likely require Congress to initiate the reforms with legislation.

<sup>146</sup> Comm. on Capital Mkts. Regulation, *The U.S. Equity Markets: A Plan for Regulatory Reform* (July 2016), [http://www.capmktreg.org/wp-content/uploads/2016/10/08\\_08\\_FINAL\\_DRAFT\\_EMS\\_REPORT-1.pdf](http://www.capmktreg.org/wp-content/uploads/2016/10/08_08_FINAL_DRAFT_EMS_REPORT-1.pdf).

<sup>147</sup> *Id.*

SIPs provide data that is already consolidated, and all broker-dealers must purchase it from exchanges to comply with their regulatory obligations.<sup>148</sup> Broker-dealers also have the option to purchase market data directly from trading venues using proprietary data feeds and consolidate it themselves.<sup>149</sup> Proprietary data feeds are attractive to market participants who can pay for them, because they have historically been faster (and more accurate) than the SIPs.<sup>150</sup> Certain data that informs trading choices, like “depth of book” information, is also only available from proprietary data feeds.<sup>151</sup>

The fees that exchanges charge for access to market data have risen over time and are increasingly important to exchange revenue. Last year for example, market data sales and related fees accounted for 44% of the revenues of Intercontinental Exchange (owner of the NYSE); in 2011, they represented only 9%.<sup>152</sup> These fees are technically reviewed by the SEC, but the agency does not typically intervene on their substance.<sup>153</sup> Furthermore, market participants often do not have a meaningful opportunity to comment on these fees (or on exchange rule changes more generally), so the perspectives and needs of investors and other market participants may be going unnoticed.

This system may be harming investors in two ways. First, the *costs* of market data may be excessive, in part because there has been little regulatory intervention in market data prices even though exchanges have monopoly pricing power.<sup>154</sup> Second, the *quality* of market data may also be compromised, particularly for those who rely on the SIPs.<sup>155</sup>

It is difficult to assess the incidence or extent of these two potential problems, because there is limited transparency surrounding market data practices. We therefore recommend that the SEC require exchanges to publicly disclose: (1) revenues from the SIPs, the allocation of these revenues among exchanges, and revenue from proprietary data feeds; and (2) performance data for the SIPs and proprietary data feeds, so that end users can compare the speeds with which they could obtain actionable market data from each.<sup>156</sup>

These disclosures will allow investors and the SEC to objectively assess whether the overall costs and quality of market data are appropriate or whether significant reform is necessary.

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<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> Alexander Osipovich, *Data Class Heats Up Between Banks and New York Stock Exchange*, Wall St. J. (Apr. 6, 2017).

<sup>153</sup> Comm. on Capital Mkts. Regulation, *The U.S. Equity Markets: A Plan for Regulatory Reform* (July 2016), [http://www.capmksreg.org/wp-content/uploads/2016/10/08\\_08\\_FINAL\\_DRAFT\\_EMS\\_REPORT-1.pdf](http://www.capmksreg.org/wp-content/uploads/2016/10/08_08_FINAL_DRAFT_EMS_REPORT-1.pdf)

<sup>154</sup> *Id.*

<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

- **The SEC should supplement its cost-benefit analysis of the consolidated audit trail with a specific analysis of the potential costs of a cyber-security breach.**

On November 15, 2016, the SEC approved a plan to create the Consolidated Audit Trail (“CAT”), an order tracking system and information repository intended to enhance the SEC’s oversight and regulation of trading activity in U.S. markets.<sup>157</sup> Once complete, the CAT will allow regulators to view “the complete lifecycle of all orders and transactions in the U.S. equity and options markets,”<sup>158</sup> including customer identity information regarding more than 100 million customer accounts.<sup>159</sup>

Given its novelty and scope, there are extensive costs and risks associated with the CAT. In April 2016, the SEC published an economic analysis of the CAT plan that attempted to evaluate these issues. Among its findings, the SEC projected initial implementation costs of roughly \$2.4 billion and ongoing industry costs of \$1.7 billion each year.<sup>160</sup> However, as noted in our report, the analysis does not consider whether these costs are allocated efficiently among stakeholders or the extent to which they will be passed onto investors.<sup>161</sup>

More troublingly, the SEC’s analysis fails to consider in detail the cybersecurity risks associated with the CAT, particularly those relating to the use and storage of “personally identifiable information” (“PII”).<sup>162</sup> The security of this sensitive customer information is of paramount importance, and many questions regarding the policies and procedures that will ensure PII safety have gone unanswered. In particular, the SEC has inadequately attempted to quantify the potential costs of a CAT security breach and confirmed that the CAT’s benefits justify these risks.

The public deserves to know how their personal information could be compromised by the CAT and what a data breach could mean for them. The SEC should promptly halt its CAT implementation efforts and specifically evaluate the CAT’s cybersecurity risks and estimate the potential costs of a breach. The agency should then publish this analysis for public comment along with an explanation as to whether the CAT’s benefits justify these costs.

<sup>157</sup> Sec. & Exch. Comm’n, Press Release, *SEC Approves Plan to Create Consolidated Audit Trail* (Nov. 15, 2016), <https://www.sec.gov/news/pressrelease/2016-240.html>.

<sup>158</sup> *Id.*

<sup>159</sup> See *id.*; Summary of the Consolidated Audit Trail Initiative (May 2015), available at <http://www.catnmsplan.com/web/groups/catnms/@catnms/documents/appsupportdocs/p571933.pdf>; Benjamin Bain and Elizabeth Dexheimer, *Google and Amazon Vie for Big Inroad Into Wall Street Data Trove*, Bloomberg (Aug. 30, 2016), <https://www.bloomberg.com/news/articles/2016-08-30/google-and-amazon-vie-for-big-inroad-into-wall-street-data-trove>.

<sup>160</sup> Sec. & Exch. Comm’n, Notice of Filing of the National Market System Plan Governing the Consolidated Audit Trail, Exchange Act Release No. 77724, 404-09 (Apr. 27, 2016), <https://www.sec.gov/rules/sro/nms/2016/34-77724.pdf>.

<sup>161</sup> Comm. on Capital Mkts. Regulation, *The U.S. Equity Markets: A Plan for Regulatory Reform* (July 2016), [http://www.capmktreg.org/wp-content/uploads/2016/10/08\\_08\\_FINAL\\_DRAFT\\_EMS\\_REPORT-1.pdf](http://www.capmktreg.org/wp-content/uploads/2016/10/08_08_FINAL_DRAFT_EMS_REPORT-1.pdf).

<sup>162</sup> See Sec. & Exch. Comm’n, Notice of Filing of the National Market System Plan Governing the Consolidated Audit Trail, Exchange Act Release No. 77724, 404-09 (Apr. 27, 2016), <https://www.sec.gov/rules/sro/nms/2016/34-77724.pdf>.



***XI. Review the U.S. Public Enforcement Regime.***

Without a doubt, effective and efficient enforcement of the laws governing our financial markets is important to the success of the U.S. economic system because it deters unlawful conduct and instills confidence in market participants. In the aftermath of the 2008 financial crisis, public enforcement authorities in the United States became increasingly aggressive in imposing large financial penalties on financial institutions and other participants in the financial system. Beginning in 2012, the Committee began to track the amount of financial penalties imposed on financial institutions by U.S. regulators.

Data collected by the Committee shows extraordinary growth in the amount of penalties since 2011. In 2011, the Committee recorded roughly \$1.6 billion in penalties imposed on financial institutions.<sup>163</sup> That exponentially increased to over \$31 billion in 2012, \$43.4 billion in 2013 and a record \$61.6 billion in 2014.<sup>164</sup> This overall increase in penalties is largely driven by enforcement actions by the Department of Justice and state attorney generals. In recent years, the penalties have begun to come back down, reaching \$13.3 billion in 2016, but they are still substantially above the amounts being levied prior to 2012.<sup>165</sup>

In light of these escalating penalty amounts, the Committee decided to examine whether the U.S. public enforcement regime governing capital markets and the financial system should be re-evaluated. Indeed, there is a general lack of understanding of how the highly complex U.S. public enforcement regime, which involves numerous agencies with overlapping authorities and jurisdiction, works in practice. Enforcement raises many issues such as: how agencies with overlapping jurisdiction coordinate with each other, whether agencies should “pile on” with concurrent sanctions and penalties, how penalty sizes are determined, whether agencies should penalize individuals or companies, and how collected penalties should be spent.

- **U.S. regulators should consider the findings of the Committee’s forthcoming report on the U.S. public enforcement regime.**

The Committee intends to publish a comprehensive report on the U.S. public enforcement regime as it applies to the U.S. financial system by the end of November 2017. The report will: (1) provide a holistic overview of how the U.S. enforcement system operates; (2) compile and present data on enforcement trends from 2000 through 2016 by agencies ranging from the SEC and CFTC to banking regulators, the CFPB and the Department of Justice; and (3) present policy recommendations on how the system could be more efficient, fair, rules-based and transparent.

The Committee looks forward to sharing the report with the Treasury Department when it is finalized. In the meantime, the Committee would be happy to provide input on any enforcement issues that the Treasury Department is presently considering.

<sup>163</sup> Comm. on Capital Mkts. Regulation, *Committee Release Quarterly Financial Penalties Data 1* (Feb. 3, 2017), <http://www.capmktreg.org/wp-content/uploads/2017/02/Q4-2016-Financial-Penalties-Release.pdf>.

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

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Should you have any questions or concerns, please do not hesitate to contact the Committee's Director, Prof. Hal S. Scott ([hscott@law.harvard.edu](mailto:hscott@law.harvard.edu)), its Executive Director of Research, John Gulliver ([jgulliver@capmksreg.org](mailto:jgulliver@capmksreg.org)), or Senior Fellow, Megan Vasios ([mvasios@capmksreg.org](mailto:mvasios@capmksreg.org)) at your convenience.

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