

# U.S. FINANCIAL REGULATORY AGENCIES AND THE RULE OF LAW



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The Committee on Capital Markets Regulation (the “Committee”) is an independent 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations. The Committee’s membership includes thirty-six leaders drawn from the finance, business, law, accounting, and academic communities. The Committee Co-Chairs are R. Glenn Hubbard, Dean Emeritus of Columbia Business School, and John L. Thornton, Former Chairman of the Brookings Institution. The Committee’s President is Hal S. Scott, Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems. 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 thanks its research staff, including John Gulliver, Executive Director, and Connor Kortje, Senior Research Fellow, for their role in the preparation of this report.

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**Executive Summary**

The Committee on Capital Markets Regulation (the “**Committee**”) is concerned that in recent years U.S. financial regulatory agencies have increasingly forgone best practices and statutorily required regulatory process in various aspects of financial regulation, supervision, and enforcement. When financial regulators have engaged in notice and comment rulemaking under the Administrative Procedure Act (“**APA**”), there have often been significant procedural shortcomings. And, in other instances, financial regulators appear to be imposing *de facto* regulations without engaging in the required notice and comment process at all.

Financial regulation that is transparent, that reflects the input of market participants, and that is consistently enforced and interpreted, is a pillar of U.S. financial markets. The efficient allocation of capital that fuels economic growth requires that regulators continue to uphold the spirit of transparency and consistency in rulemaking, supervision, and enforcement. The trend toward arbitrary rulemaking, supervision, and enforcement discussed herein goes against this spirit and therefore threatens to undermine the preeminence of U.S. financial markets. The Committee calls on U.S. financial regulators to restore their commitment to the norms of transparency and consistency. We also call for the President’s Working Group on Financial Markets and appropriate congressional committees to conduct a comprehensive review of the trend discussed herein.

In this report we identify ten instances of this trend, divided into three categories. Although most of the instances we discuss relate to the most recent two years, others constitute longstanding concerns that the Committee has highlighted in earlier reports.

The first category consists of recent instances in which the notice and comment rulemaking process has involved material procedural shortcomings. Under this category we describe how recent rulemaking proposals by the Securities and Exchange Commission (“**SEC**”) have (1) contained inadequate cost-benefit analysis, and (2) departed from established principles guiding the length of comment periods, thereby depriving commenters of adequate time to respond.

The second category consists of instances in which a financial regulatory agency has imposed *de facto* regulations on market participants without engaging in the notice and comment rulemaking process. The first two issues we describe in this category consist of recent occurrences: (1) a recent announcement by the Office of the Comptroller of the Currency (“**OCC**”) that it may withhold consent to certain regional bank mergers unless the regional bank’s living will meets parameters that the agency has failed to disclose, and (2) the decision of the Federal Trade Commission (“**FTC**”) to subject private equity acquisitions to higher standards of antitrust review. The other two are issues on which the Committee has already expressed its view in prior reports: (3) the Federal Reserve’s development of the factual scenarios and models underlying bank stress tests outside of the APA’s notice and comment rulemaking process, and (4) bank regulators’ use of confidential criteria for assessing banks’ living wills.

The third category consists of instances in which a regulator has selectively or inconsistently enforced or interpreted existing rules. Under this category we describe (1) the SEC’s announcement that it would decline to enforce a rule regulating proxy advisers during the pendency of a legal challenge to the rule, (2) the Department of Labor’s (“**DOL**”) inconsistent

guidance on the permissibility of private equity investments by 401(k) plans, (3) the SEC's use of a purported regulatory "clarification" to effect an unauthorized expansion of the statutory definition of "underwriter" in the context of SPAC and de-SPAC transactions, and (4) the SEC's alteration of its longstanding application of the rules regulating Rule 144A debt offerings.



**A. Deficiencies in the notice and comment rulemaking process**

This section discusses recent instances in which the SEC’s notice and comment rulemaking process lacked adequate cost-benefit analysis and departed from established principles that guide the length of time accorded to commenters to respond to a rulemaking proposal.

1) Lack of adequate cost-benefit analysis

Several of the most significant recent SEC rulemaking proposals, in particular those addressing position disclosure,<sup>1</sup> money market funds,<sup>2</sup> private funds,<sup>3</sup> dealer registration,<sup>4</sup> climate change disclosure,<sup>5</sup> and SPACs,<sup>6</sup> have exhibited significant shortcomings in their cost-benefit analyses (“CBAs”). The Committee was not alone in finding recent CBAs by the SEC to have fundamental

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<sup>1</sup> We refer here to the SEC’s proposed rules on security-based swaps (SEC, *Prohibition Against Fraud, Manipulation, or Deception in Connection With Security-Based Swaps; Prohibition Against Undue Influence Over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions* 87 FR 6652 (Feb. 2, 2022), <https://www.federalregister.gov/documents/2022/02/04/2021-27531/prohibition-against-fraud-manipulation-or-deception-in-connection-with-security-based-swaps>), reporting of securities loans (SEC, *Reporting of Securities Loans* 86 FR 69802 (Dec. 8, 2021), <https://www.federalregister.gov/documents/2021/12/08/2021-25739/reporting-of-securities-loans>), short position and short activity reporting (SEC, *Short Position and Short Activity Reporting by Institutional Investment Managers* 87 FR 14950 (Mar. 16, 2022), <https://www.federalregister.gov/documents/2022/03/16/2022-04670/short-position-and-short-activity-reporting-by-institutional-investment-managers>), and beneficial ownership reporting (SEC, *Modernization of Beneficial Ownership Reporting* 87 FR 13846 (Mar. 10, 2022), <https://www.federalregister.gov/documents/2022/03/10/2022-03222/modernization-of-beneficial-ownership-reporting>).

<sup>2</sup> SEC, *Money Market Fund Reforms* 87 FR 7248 (Feb. 8, 2022), <https://www.federalregister.gov/documents/2022/02/08/2021-27532/money-market-fund-reforms>.

<sup>3</sup> SEC, *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, 87 FR 16866 (Mar. 24, 2022), available at <https://www.federalregister.gov/documents/2022/03/24/2022-03212/private-fundadvisers-documentation-of-registered-investment-adviser-compliance-reviews>

<sup>4</sup> SEC, *Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer*, 87 FR 23054 (Apr. 18, 2022), <https://www.federalregister.gov/documents/2022/04/18/2022-06960/further-definition-of-as-a-part-of-a-regular-business-in-the-definition-of-dealer-and-government>.

<sup>5</sup> SEC, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, 87 FR 21334 (Apr. 11, 2022) <https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of-climate-related-disclosures-for-investors>.

<sup>6</sup> SEC, *Special Purpose Acquisition Companies, Shell Companies, and Projections*, 87 Fed. Reg. 29458, 574 (May 13, 2022), <https://www.federalregister.gov/documents/2022/05/13/2022-07189/special-purpose-acquisition-companies-shell-companies-and-projections>.

flaws. Various other commenters have come to the same conclusion, both with respect to these proposals,<sup>7</sup> and other recent proposals.<sup>8</sup>

As we noted in our comment letters on the SEC proposals, the adequacy of the CBA goes to the heart of the advisability and legal validity of a rulemaking proposal. The SEC is required by statute to consider whether a rulemaking will “promote efficiency, competition, and capital formation.”<sup>9</sup> The federal courts have held that the APA requires a weighing, and where possible quantification by the SEC, of the costs and benefits of a proposed regulation.<sup>10</sup> And courts have invalidated SEC rulemakings based on inadequate consideration or quantification of costs and benefits of the proposal for market participants.<sup>11</sup> Shortcomings in the CBA therefore raise serious concerns as to both the process and content of recent rulemakings, as well as their legal validity.

These shortcomings are detailed further in our comment letters responding to these proposals. We summarize here two examples of some of the most significant shortcomings.

The CBA for the proposed rule on private investment funds (“Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews”)<sup>12</sup> was premised on an unsubstantiated market failure in the negotiating process between private fund advisers and their investors, ignoring evidence that it is often the investor with superior bargaining power.<sup>13</sup> It also failed to consider empirical evidence that the bargaining process between private fund advisers and their investors is economically efficient.<sup>14</sup> The CBA therefore failed to consider the potential

<sup>7</sup> See, e.g., James A. Overdahl, *The SEC’s Proposed Rule for the Enhancement and Standardization of Climate-Related Disclosures for Investors* (June 16, 2022), <https://www.sec.gov/comments/s7-10-22/s71022-20131892-302347.pdf>; Craig M. Lewis, *The SEC’s Proposed Rules for Private Fund Advisers* (Apr. 25, 2022), <https://www.managedfunds.org/wp-content/uploads/2022/04/MFA-Comment-Letter-on-Private-Fund-Adviser-Proposal-with-Economic-Study-as-submitted-on-4.25.22.pdf>; Elliott Investment Management L.P., Comment Letter on Security-Based Swaps Proposal (Mar. 21, 2022), <https://www.sec.gov/comments/s7-32-10/s73210-20120750-272913.pdf>; Bank Policy Institute, Comment Letter on Climate Change Disclosures Proposal (June 16, 2022), <https://www.sec.gov/comments/s7-10-22/s71022-20131389-301543.pdf>; SIFMA, *Too much, too quickly from the SEC* (Apr. 15, 2022), <https://www.sifma.org/resources/news/the-hill-too-much-too-quickly-from-the-sec/>.

<sup>8</sup> See, e.g., Association for Digital Asset Markets, ADAM Comment Letter Regarding SEC Proposed Changes to Regulation ATS, Rule 3b-16, and Regulation SCI (Apr. 18, 2022), <https://www.theadam.io/adam-sec-regulation-ats-comment-letter/>.

<sup>9</sup> National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C.).

<sup>10</sup> *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005); see also PAUL ROSE & CHRISTOPHER WALKER, CTR. FOR CAPITAL MKTS. COMPETITIVENESS, THE IMPORTANCE OF COST-BENEFIT ANALYSIS IN FINANCIAL REGULATION 24–33 (2013), <http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/CBA-Report-3.10.13.pdf>.

<sup>11</sup> *Chamber of Commerce*, 412 F.3d at 144; *Bus. Roundtable v. SEC*, 647 F.3d, 1144 (D.C. Cir. 2011).

<sup>12</sup> SEC, *supra* note 3.

<sup>13</sup> See Comm. on Capital Mkts. Reg. (“CCMR”), Comment Letter on Private Funds Proposal at 14 (Apr. 25, 2022), citing Elisabeth de Fontenay et al., *Side Letter Governance* WASHINGTON UNIVERSITY L. REV. (forthcoming, 2022), <https://www.capmktreg.org/wp-content/uploads/2022/04/CCMR-Comment-Letter-Private-Funds-Proposal-04.25.2022.pdf>.

<sup>14</sup> *Id.* at 17, citing Yaron Brook & Ramesh K. S. Rao, *Shareholder Wealth Effects of Directors’ Liability Limitation Provisions*, 29 J. OF FIN. AND QUANTITATIVE ANALYSIS 3 (1994).

economic costs to market participants of interfering in that process by prohibiting or restricting parties from freely agreeing to certain terms.<sup>15</sup>

The CBA for the proposed rule on climate change disclosures for public issuers (“Enhancement and Standardization of Climate-Related Disclosures for Investors”)<sup>16</sup> ignored certain crucial findings of the studies that it cited in support of the proposal, including that climate disclosure mandates produce on average an overall negative market reaction and necessitate costly operational adjustments that reduce shareholder value.<sup>17</sup> The Committee also found more generally that the CBA in the proposal failed to substantiate how the proposed mandate would produce any marginal benefits beyond those produced by the existing materiality standard.<sup>18</sup>

Although recent CBAs by the SEC have been lengthy and purported to examine many issues, they have often been based on material factual inaccuracies, riddled with conclusory assertions, failed to contend with fundamental issues, and ignored large amounts of empirical research that reveal the potential for significant costs or cast doubt on purported benefits of a proposal. We are concerned that this reflects a trend of seeking to demonstrate a technical or superficial compliance with the barest reading of the requirements of the APA with the aim of achieving a specific regulatory agenda rather than treating the CBA as an opportunity for an objective and self-critical analysis of the costs and benefits of the proposed rule. Inadequate CBA also exposes rulemakings to legal challenges thereby creating costly market uncertainty.

More generally, individual CBAs have failed to consider the implications of the other proposed but yet to be adopted rulemaking proposals and the overall impact of the substantial volume of proposed reforms.<sup>19</sup>

We therefore call on the SEC to re-propose these recent rulemakings with amended CBAs that address the flaws described herein, and to ensure that CBAs issued in connection with future rulemakings avoid repeating these flaws.

## 2) Insufficient time to comment

Recent SEC rulemaking proposals have departed from the norms that have traditionally guided the length of public comment periods. This departure has compromised the proper function of the notice and comment rulemaking process by making it impracticable for commenters to meaningfully analyze and respond to the proposals, many of which are often complex and can be

<sup>15</sup> *Id.* at 17-18, citing Yuyan Guan et al., *Managerial Liability and Corporate Innovation: Evidence from a Legal Shock*, J. OF CORP. FIN. (forthcoming).

<sup>16</sup> SEC, *supra* note 5.

<sup>17</sup> See CCMR, Comment Letter Re. Enhancement and Standardization of Climate Related Disclosures for Investors at 14 (June 16, 2022), <https://www.capmksreg.org/wp-content/uploads/2022/06/CCMR-Comment-Letter-Climate-Disclosure-Proposal-06.16.2022.pdf>, citing Valentin Jouvenot & Philipp Krueger, *Mandatory Corporate Carbon Disclosure: Evidence from a Natural Experiment* (2019), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3434490](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3434490).

<sup>18</sup> *Id.* at 14.

<sup>19</sup> See CCMR, THE UNPRECEDENTED INCIDENCE OF SEC PROPOSED AND FINAL RULEMAKINGS (2022), <https://www.capmksreg.org/wp-content/uploads/2022/07/sec-rulemaking-diagram.pdf>.

expected to have significant impacts on markets and investors. The pattern that emerged is indicative of a recent tendency of departing from the established norms and best practices that have traditionally undergirded the effectiveness of the U.S. regulatory environment.

The APA does not specify a minimum number of days for comment periods; however, the courts have ruled that a comment period must “provide a meaningful opportunity to comment” and that 30 days is generally the shortest time period sufficient to meet this standard.<sup>20</sup> Moreover, the norms that have traditionally guided agency rulemakings establish that the public should ordinarily be given more time to comment, commensurate with the relative complexity of the proposal. In particular, the executive order that sets forth general principles for the issuance of regulations by federal agencies, including the SEC, indicates that the public should in most cases be given a minimum of 60 days to comment on a rule proposal.<sup>21</sup> The Office of the Federal Register’s Guide to the Rulemaking Process, which does not establish binding rules but which describes rulemaking norms and practices, provides that for more complex proposals, agencies may provide for longer periods, even in excess of 180 days.<sup>22</sup>

In setting comment periods, recent SEC proposals have departed from these principles by issuing a significant number of proposals with 30-day comment periods from the publication in the Federal Register. During 2021, seven rulemaking proposals were issued with such 30-day comment periods, which exceeds the number of 30-day comment periods in the prior seven years.<sup>23</sup> These short comment periods were not justified by immediate exigencies and disregarded the relative complexity of these proposals, both individually and in the aggregate. Although certain subsequent proposals purported to provide for comment periods of up to 60 days, the timeframe was in fact formulated such that the comment period would potentially run for only 30 days following publication of the final proposal in the Federal Register. This reformulation thus still reflected a significant departure from precedent and failed to ensure that commenters were afforded sufficient time to respond to the proposal. Moreover, given the typical practice of providing for comment periods that are commensurate with the complexity and significance of the proposal, even a comment period of 60 days is arguably insufficient. The SEC’s recent rulemaking proposals form part of a SEC regulatory agenda that has been unprecedented in its volume, significance, complexity, and interconnectedness. According to an estimate by SIFMA, the proposals concerning climate-related disclosures, money market fund reforms, private funds, short-sale reporting, securities lending, security-based swaps reporting, special purpose acquisition companies, shortening the settlement cycle, amendments to Regulation ATS, and cybersecurity risk management rules, along with other proposals<sup>24</sup> that constitute merely a subset of the

<sup>20</sup> See *Nat’l Lifeline Ass’n v. FCC*, 921 F.3d 1102, 1117 (D.C. Cir. 2019).

<sup>21</sup> Executive Order 12866 of Sept. 30, 1993, Fed. Reg. Vol. 58 No. 190 (Oct. 4, 1993), <https://www.archives.gov/files/federal-register/executive-orders/pdf/12866.pdf>.

<sup>22</sup> *A Guide to the Rulemaking Process*, OFFICE OF THE FEDERAL REGISTER, [https://www.federalregister.gov/uploads/2011/01/the\\_rulemaking\\_process.pdf](https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf) (last visited Aug. 23, 2022).

<sup>23</sup> See JENNIFER J. SCHLUP & NICHOLAS ANTHONY, CATO INSTITUTE, *THE SEC SHORT-CHANGES PUBLIC COMMENT* (2022), <https://www.cato.org/blog/sec-short-changes-public-comment>.

<sup>24</sup> SEC, *Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer*, *supra* note 4; SEC, *Modernization of Beneficial Ownership Reporting*, *supra* note 1; SEC, *Request for Information and Comments on Broker-Dealer and Investment Adviser Digital Engagement Practices*, 86 FR 49067 (Sept. 1, 2021), <https://www.federalregister.gov/documents/2021/09/01/2021-18901/request-for-information-and-comments-on-broker-dealer-and-investment-adviser-digital-engagement>.

rulemaking proposals and requests for information issued by the SEC within a 12-month period, comprised 3,570 pages and 2,260 questions.<sup>25</sup>

The shortened comment periods provided for with these various major proposals failed to provide the public with a meaningful opportunity to comment. The fact that such a large number of complex proposals implicating interconnected issues were issued within such a short timeframe provided very little time for market participants to review and analyze the proposals, and hence made it more difficult for them to respond to the proposals effectively.<sup>26</sup> The SEC proposed or finalized 26 substantive rulemakings over the 15 months following Chairman Gensler’s confirmation on April 27, 2021.<sup>27</sup> Moreover, as the Committee noted in a recent report, these proposals are highly interconnected.<sup>28</sup> As in the case of the CBAs, the comment periods associated with these proposals have failed to take account of the overall volume and interdependencies of the full set of rulemakings issued over this period, as other commentators have observed.<sup>29</sup>

Even a comment period of 60 days would be at the lower end of the spectrum given the complexity and volume of recent proposals. We are more generally concerned that the significant departure from established principles exemplifies a broader trend of eroding best practices in rulemaking to achieve a specific regulatory agenda to the detriment of the integrity of the overall rulemaking process and U.S. financial regulation generally. We call on the SEC to provide for comment periods that reflect the complexity and volume of rulemaking and to allow the public a meaningful opportunity to comment on the overall effect of its unprecedented rulemaking agenda.

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<sup>25</sup> BPI, SIFMA *et al.*, Letter to Chair Gensler, “Importance of Appropriate Length of Comment Periods” 4 (Apr. 5, 2022), <https://fsforum.com/a/media/importance-of-appropriate-length-of-comment-periods.pdf>.

<sup>26</sup> *Id.* at 11.

<sup>27</sup> CCMR, *supra* note 19 at 1.

<sup>28</sup> *Id.*

<sup>29</sup> Ass’n for Digital Asset Markets, Comment Letter Regarding SEC Proposed Changes to Regulation ATS, Rule 3b-16 and Regulation SCI (Apr. 18, 2022), <https://www.theadam.io/adam-sec-regulation-ats-comment-letter/> (“Even longer comment periods are needed where rulemakings are complex or where an agency is engaged in multiple rulemakings at or near the same time. Given that this rulemaking is complex and that the SEC has multiple rulemakings occurring in parallel, ADAM believes that the substantive changes to Rule 3b-16 require at least a 90-day comment period from publication in the Federal Register, a point that ADAM conveyed in its February 2, 2022 letter to the SEC.”).

**B. Development of rules outside the notice and comment rulemaking process**

In this section we discuss four examples of financial regulatory agencies declining to engage in the notice and comment rulemaking process and choosing instead to apply confidential criteria or impose substantive requirements by leveraging their discretionary powers. First, we discuss two recent manifestations of this trend: namely the OCC’s use of its merger approval powers to impose new living will requirements, and the FTC’s creation of new antitrust standards for private equity acquisitions. We then describe two examples of this trend that the Committee has expressed its view on in prior reports: namely the Federal Reserve’s development of the models and assumptions underlying stress test results and the criteria used by banking regulators to assess banks’ resolution plans (“living wills”) outside the public rulemaking process.<sup>30</sup>

1) Imposing additional living will requirements with a merger moratorium

Since the enactment of the Dodd-Frank Act large banks have been required to create “living wills” – plans that describe how a bank would be resolved if it were to experience “material financial distress or failure.”<sup>31</sup> The Federal Reserve (“Fed”) and Federal Deposit Insurance Corporation (“FDIC”) review these plans. If those regulators do not approve a bank’s living will, then they may require the banks to submit a revised plan. If the revised plan fails to address the shortcomings, then they may “jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on the growth, activities, or operations of the organization.”<sup>32</sup>

In June of 2022, the Acting Comptroller of the Currency, Michael Hsu, indicated in a speech that the OCC, the agency responsible for the supervision of all national banks, intended to withhold consent to the merger of any large regional banks (that is, banks with more than \$500 billion in assets) while regulators considered if regional banks’ living wills should be required to provide for a single point of entry resolution and the issuance of a significant amount of unsecured “bail-in-able” debt (an “SPOE/TLAC” requirement).<sup>33</sup> Acting Comptroller Hsu suggested that leveraging the OCC’s discretionary merger approval power in this manner was necessary to address urgent risks to the financial system, and that although these requirements could ultimately be developed through the rulemaking process, there was insufficient time to do so.<sup>34</sup>

<sup>30</sup> See, e.g., CCMR, ROADMAP FOR REGULATORY REFORM (2018), <https://www.capmksreg.org/wp-content/uploads/2018/10/Roadmap-for-Regulatory-Reform.pdf>; CCMR, REVISITING THE APPLICATION OF THE ADMINISTRATIVE PROCEDURE ACT TO BANKING SUPERVISION AND REGULATION (2021), <https://www.capmksreg.org/2021/09/20/committee-statement-on-the-administrative-procedure-act-and-banking-supervision/>.

<sup>31</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. 1376 (2010), Section 165(d); see also Hal S. Scott, *Publish the Secret Rules for Banks’ Living Wills* THE WALL STREET JOURNAL (Jun. 10, 2016) <https://www.capmksreg.org/2016/06/10/op-ed-publish-the-secret-rules-for-banks-living-wills/>.

<sup>32</sup> See BANK POLICY INSTITUTE, BANKING BRIEF: LIVING WILL REQUIREMENTS FOR BANKING ORGANIZATIONS (2014), <https://bpi.com/banking-brief-living-will-requirements-for-banking-organizations/>.

<sup>33</sup> See JOHN COURT & GREGG ROZANSKY, BANK POLICY INSTITUTE, ANY MAJOR REVAMP OF BANK RESOLUTION PLAN REQUIREMENTS SHOULD BE DONE ONLY THROUGH RULEMAKING (2022), <https://bpi.com/any-major-revamp-of-bank-resolution-plan-requirements-should-be-done-only-through-rulemaking/>.

<sup>34</sup> See *id.*

Currently, SPOE/TLAC requirements apply only to global systemically important banks (“G-SIBs”). The proposed merger conditions would thus effectively amend the living will requirements for large regional banks that seek to complete an acquisition. The imposition of a SPOE/TLAC requirement would require regional banks to raise additional capital or debt, thus imposing administrative compliance costs, transaction costs, and potentially higher costs of capital. This may in turn cause such banks to reduce their lending activities.

The OCC’s announcement has in fact already had an impact on merger activity. Since the OCC’s announcement, an \$8 billion acquisition by U.S. Bancorp failed to meet its target closing date while awaiting regulatory approval. The OCC’s proposed course of action also threatened to delay a \$16.3 billion acquisition by Bank of Montreal and a \$13.4 billion acquisition by Toronto-Dominion Bank.<sup>35</sup>

The use of the merger approval process to create new *de facto* living will requirements implicates several procedural and fairness concerns.

First, such an action would result in inconsistent treatment of banks of equivalent size. As such, it would arguably effect an arbitrary regulatory action under the APA. For example, under the proposed approach, a bank that grows above the \$500 billion asset threshold through organic growth would not be subject to the SPOE/TLAC requirement, but one that seeks to do so through acquisitions would be, even if the banks have similar risk profiles.<sup>36</sup>

Such a policy would also conflict with the framework established by Congress for the administration of the living will requirements: Section 165(d) of the Dodd Frank Act specifically tasks the Fed and FDIC, but not the OCC, with reviewing banks’ resolution plans to determine whether they are credible. Moreover, the living will requirements have been set by the Fed and FDIC, not the OCC, through the notice and comment rulemaking process. The OCC’s proposed merger conditions in effect apply an SPOE/TLAC requirement to a category of banks to which the Fed and FDIC requirements did not apply.

The prospect of the OCC modifying bank living will requirements in this manner represents a significant and troubling trend of abandoning the norms that have traditionally guided the creation and amendment of financial regulation. The OCC should therefore abandon this policy and commit that changes to the living will requirements will only be made through the proper notice and comment rulemaking process.

2) The FTC’s special antitrust standards for private equity acquisitions

Recent statements and regulatory actions by the FTC and Justice Department indicate that these agencies intend to subject private equity financed acquisitions to heightened antitrust review.<sup>37</sup>

<sup>35</sup> See Justin Baer & Andrew Ackerman, *U.S. Weighs New Rules for Regional Banks, Complicating Merger Plans* THE WALL STREET JOURNAL (Aug. 6, 2022), <https://www.wsj.com/articles/u-s-weighs-new-rules-for-regional-banks-complicating-merger-plans-11659748861>.

<sup>36</sup> See *id.*

<sup>37</sup> Makan Delrahim, *Antitrust Attacks on Private Equity Hurt Consumers*, THE WALL STREET JOURNAL (July 31, 2022), <https://www.wsj.com/articles/antitrust-attacks-on-private-equity-hurt-consumers-lina-khan-ftc-recession-competition-management-expertise-capital-11659271442>.

FTC Chair Lina Khan suggested that this increased scrutiny is necessitated by the private equity business model, which she contended "may in some instances distort incentives in ways that strip productive capacity, degrade the quality of goods and services, and hinder competition."<sup>38</sup> The FTC has already put this increased scrutiny into effect: as a condition of its approval of one private equity-financed acquisition, the FTC determined that the acquirer will be required to seek FTC permission to engage in certain subsequent acquisitions in the same industry.<sup>39</sup> The FTC's policy reflects significant judgments about complex issues. These include the role of private equity in the allocation of capital and management expertise among and within industries and the resulting effects on consumers.<sup>40</sup> The notice and comment rulemaking process is designed to allow market participants to provide information bearing on the underlying rationale of a proposed rulemaking and to have that evidence noted in the public record. The FTC should abandon its efforts to impose *de facto* amendments to antitrust standards of review by fiat and commit to effecting significant changes to antitrust policy through the notice and comment rulemaking process.

3) Withholding bank stress test models and assumptions from the public rulemaking process

The Fed conducts annual stress tests to assess whether the largest bank holding companies in the United States have adequate capital to weather adverse economic and financial conditions. To conduct the stress test, the Fed uses its own economic models to project the impact of a hypothetical scenario of economic and financial distress on bank losses. The results of a bank's stress test are then used to calculate a bank's "stress capital buffer." If a bank's risk-weighted capital falls below the sum of its stress capital buffer, minimum regulatory capital requirements, and other applicable capital buffers, then the Fed can restrict the bank's distributions to its shareholders. The stress test effectively establishes binding capital constraints for many large U.S. banks.

The Fed develops new models and new scenarios each year to predict how a hypothetical crisis would affect banks' capital levels. Although the Fed publishes certain high-level information about its models, it does not disclose important details. For example, details about portfolio composition, model changes, backtesting, and assumptions are not disclosed.<sup>41</sup> Similarly, although the Fed publishes the details of its hypothetical crisis scenarios before the test is conducted, it does not allow the public to comment on them.

<sup>38</sup> See FEDERAL TRADE COMMISSION Statement of Chair Lina M. Khan (Jun. 13, 2022) [https://www.ftc.gov/system/files/ftc\\_gov/pdf/2022.06.13%20-%20Statement%20of%20Chair%20Lina%20M.%20Khan%20Regarding%20NVA-Sage%20-%20new.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/2022.06.13%20-%20Statement%20of%20Chair%20Lina%20M.%20Khan%20Regarding%20NVA-Sage%20-%20new.pdf).

<sup>39</sup> See FEDERAL TRADE COMMISSION, Concurring Statement of Commissioners Noah Joshua Phillips and Christine S. Wilson Docket No. C-4766 (June 13, 2022), <https://www.ftc.gov/legal-library/browse/cases-proceedings/public-statements/concurring-statement-commissioners-noah-joshua-phillips-christine-s-wilson>.

<sup>40</sup> See Delrahim, *supra* note 37.

<sup>41</sup> See Enhanced Disclosure of the Models Used in the Federal Reserve's Supervisory Stress Test (Feb. 28, 2019) <https://www.federalregister.gov/documents/2019/02/28/2019-03505/enhanced-disclosure-of-the-models-used-in-the-federal-reserves-supervisory-stress-test#citation-4-p6785>; CCMR, Letter Re. Docket No. OP-1586, Enhanced Disclosure of the Models Used in the Federal Reserve's Supervisory Stress Test (Jan. 19, 2018), [https://www.capmktreg.org/wp-content/uploads/2018/01/1\\_19\\_18\\_CCMR-FINAL\\_Comment\\_Letter\\_Fed-Stress-Test-Proposals.pdf](https://www.capmktreg.org/wp-content/uploads/2018/01/1_19_18_CCMR-FINAL_Comment_Letter_Fed-Stress-Test-Proposals.pdf).



As the Committee has argued in prior reports, the APA fully applies to supervisory and regulatory actions by the Fed, including the setting of stress testing requirements.<sup>42</sup> As such, if the stress test models and hypothetical scenarios are rules rather than adjudications, then they are required to be developed through notice and comment rulemaking.<sup>43</sup> We believe that the Fed’s stress test scenarios and models are rules and not adjudication under the APA because they: (a) are generally applicable to a group of banks, (b) have future effect through their significant influence over a bank’s ability to make capital distributions, and (c) establish *de facto* capital requirements.<sup>44</sup> There is therefore no legal basis for denying public comment on the models and scenarios that underlie the tests.

Daniel Tarullo, former member of the Fed’s Board of Governors, has argued that Section 165 of the Dodd-Frank Act and Section 908 of the International Lending Supervision Act (“ILSA”) exempt the Fed’s stress testing regime from any APA requirements that would otherwise apply.<sup>45</sup> According to this argument, the fact that these sections refer to the capital measures that they impose as “standards” rather than “regulations” suggests that Congress may have contemplated more procedural flexibility in implementing these standards via stress tests than the APA would allow.<sup>46</sup> As we discussed in our prior report, there are several factors that make this argument unpersuasive. In particular, the APA provides explicitly that a subsequent statute may not modify or supersede its provisions “except to the extent it does so expressly.”<sup>47</sup> Nothing in the Dodd Frank Act or ILSA expressly modifies or supersedes the APA. Courts have moreover consistently rejected similar arguments to the effect that other areas of law, namely tax and patent law, are exempt from the APA’s procedural requirements.<sup>48</sup>

In addition to the legal argument, and also as we have noted in prior reports, disclosing the stress test models and assumptions and submitting them to notice and comment rulemaking is advisable from a policy perspective. Stress test results can effectively require banks to hold more capital, and higher capital requirements have been demonstrated to cause banks to curtail their lending activities and slow economic growth. Requiring banks to hold more capital than what is reasonably necessary can therefore impose significant costs on the economy. Submitting the scenarios and models that underlie the stress tests to public scrutiny has the potential to increase their accuracy and effectiveness and avoid unnecessarily incurring such costs.

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<sup>42</sup> CCMR, REVISITING THE APPLICATION OF THE ADMINISTRATIVE PROCEDURE ACT TO BANKING SUPERVISION AND REGULATION (2021), <https://www.capmksreg.org/2021/09/20/committee-statement-on-the-administrative-procedure-act-and-banking-supervision/>; CCMR, THE ADMINISTRATIVE PROCEDURE ACT AND FEDERAL RESERVE STRESS TESTS – ENHANCING TRANSPARENCY (2016), <https://www.capmksreg.org/wp-content/uploads/2019/05/The-Administrative-Procedure-Act-and-Federal-Reserve-Stress-Tests-Enhancing-Transparency.pdf>; Hal S. Scott & John Gulliver, *The Fed’s Stress Tests Need to Be Transparent* THE WALL STREET JOURNAL (Sept. 19, 2016), <https://www.capmksreg.org/2016/09/19/op-ed-fed-stress-tests-and-the-administrative-procedure-act/>.

<sup>43</sup> See 5 U.S.C. §§ 553-554.

<sup>44</sup> See CCMR, *supra* note 42 at 3.

<sup>45</sup> Daniel K. Tarullo, *Bank Supervision and Administrative Law* COLUMBIA BUSINESS LAW REVIEW 2022(1) (2022) <https://journals.library.columbia.edu/index.php/CBLR/article/view/9983>.

<sup>46</sup> *Id.*

<sup>47</sup> CCMR *supra* note 44 at 2, quoting 5 U.S.C. § 559.

<sup>48</sup> *Id.* at 6-10.

The stress test scenarios and models should therefore be publicly disclosed, and the public provided with an opportunity to comment on them pursuant to a notice and comment rulemaking process.

4) Application of confidential living will criteria

The general criteria for living wills are set forth in publicly issued regulations that stipulate the basic structure and content of a resolution plan.<sup>49</sup> For example, they specify that the resolution plan must include a strategic analysis that describes, among other things, the specific actions that the bank will take to facilitate a rapid and orderly resolution, the bank’s “funding, liquidity and capital needs,” which must be “mapped to its identified critical operations and core business lines,” and the bank’s strategy for “maintaining operations of, and funding for, itself and its material entities.”<sup>50</sup>

Regulators have also traditionally provided guidance to the eight largest U.S. banks as to certain general standards that are used to assess their plans. This guidance indicates, for example, that regulators expect such banks to model resolution capital and liquidity needs for each material entity in their structures and to hold and pre-position sufficient resources to meet those needs. It also indicates that in estimating its minimum liquidity needs a bank should estimate the minimum operating liquidity at each of its material entities, provide daily cash flow forecasts, and provide a comprehensive breakout of all inter-affiliate transactions and arrangements that could impact minimum liquidity needs.<sup>51</sup>

However, more specific and quantitative criteria – such as whether a particular legal structure is required, or the extent of capital and liquidity assumed to be necessary at any given entity or overall to avoid disrupting operations – are not disclosed. This has meant that large banks, despite investing millions of dollars and hours in developing living wills, have on occasion failed to create plans that satisfy regulators.<sup>52</sup>

As the Committee has previously argued, the confidentiality of the living will requirements, and the fact that the criteria are not developed through a notice and comment rulemaking process, imposes meaningful costs.<sup>53</sup> It has increased compliance costs for banks significantly. It has also meant that the specific and quantitative requirements do not reflect the rigor and scrutiny of the public comment process. The lack of transparency regarding the operative criteria used to assess living wills reduces the effectiveness of the living will requirement by making it more difficult for banks to design plans in which the market has confidence. Further developing living will requirements through the notice and comment rulemaking process would also make it less likely

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<sup>49</sup> 12 CFR part 243, <https://www.ecfr.gov/current/title-12/chapter-II/subchapter-A/part-243>; 12 CFR part 381, <https://www.ecfr.gov/current/title-12/chapter-III/subchapter-B/part-381>.

<sup>50</sup> 12 CFR part 243, § 243.5(c).

<sup>51</sup> See BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM & FDIC, *2019 Final Guidance*, 84 FR 1438, <https://www.federalregister.gov/documents/2019/02/04/2019-00800/final-guidance-for-the-2019>.

<sup>52</sup> Hal S. Scott, *Publish the Secret Rules for Banks’ Living Wills* THE WALL STREET JOURNAL (Jun. 10, 2016) <https://www.capmksreg.org/2016/06/10/op-ed-publish-the-secret-rules-for-banks-living-wills/>.

<sup>53</sup> See *id.*

that the requirements could be invalidated by a court.<sup>54</sup> The Fed and FDIC should therefore make public the specific criteria that are used to assess banks' resolution plans.

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<sup>54</sup> *See id.*

**C. Inconsistent rule enforcement and interpretation**

In this section we discuss four significant and concerning examples of inconsistent enforcement and interpretation of pre-existing regulatory rules, namely (1) the SEC’s non-enforcement policy with respect to the rule applicable to proxy advisers, (2) the inconsistent guidance issued by the DOL regarding private equity investments by 401(k) plans, (3) the SEC’s use of a purported regulatory “clarification” to effect an unauthorized expansion of the statutory definition of “underwriter” in the context of SPAC and de-SPAC transactions, and (4) the SEC’s reversal of its longstanding interpretation of the rules applicable to private debt offerings.

1) SEC non-enforcement of proxy adviser rule

In July 2020 the SEC adopted rule amendments requiring proxy advisory firms to disclose conflicts of interest and to ensure that proxy voting advice is made available to public companies at or before the time such advice is disseminated to clients. The SEC also affirmed by rule its prior interpretation that proxy advisers’ reports are “solicitations,” the effect of which is to subject them to the proxy rules’ anti-fraud provisions.<sup>55</sup>

On June 1, 2021, Chairman Gensler stated that he was directing the SEC staff to consider whether to recommend that the SEC revisit these reforms.<sup>56</sup> The staff of the SEC’s Division of Corporation Finance stated that it would not recommend any enforcement action for violations of the recently adopted rules governing proxy voting advice while the Commission’s reconsideration was underway.<sup>57</sup> The 2021 non-enforcement statement also suggested that the staff would not recommend any enforcement action “for a reasonable period of time” following the resumption of a legal challenge to the rule by Institutional Shareholder Services.<sup>58</sup> In September 2022, a federal court ruled that the SEC’s policy of non-enforcement was an unlawful agency action.<sup>59</sup>

In addition to the legal issues noted in the court’s decision, the SEC’s actions raise broader policy issues. A policy of non-enforcement of any rule that is being challenged in litigation may invite parties to bring legal challenges against rules to avoid their enforcement. More generally, as we noted in our prior statement, the SEC’s actions in this regard could produce broader costs.<sup>60</sup> Although the significance of the proxy adviser amendments specifically has now been mooted by the SEC’s issuance of a rule overturning those amendments, the SEC’s non-enforcement policy raises a more fundamental and general issue that implicates market participants’ ability to rely on the rulemaking process. The practice of issuing such statements could spread to other SEC

<sup>55</sup> CCMR, SEC STAFF NON-ENFORCEMENT OF PROXY ADVISOR REGULATIONS (2021), <https://www.capmktreg.org/2021/07/07/sec-staff-non-enforcement-of-proxy-advisor-regulations/>.

<sup>56</sup> SEC, Chairman Gary Gensler, Statement on the application of the proxy rules to proxy voting advice (June 1, 2021), <https://www.sec.gov/news/public-statement/gensler-proxy-2021-06-01>.

<sup>57</sup> SEC, Statement on Compliance with the Commission’s 2019 Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice and Amended Rules 14a-1(1), 14a-2(b), 14s-9 (June 1, 2021), <https://www.sec.gov/news/public-statement/corp-fin-proxy-rules-2021-06-01>.

<sup>58</sup> *Id.*

<sup>59</sup> See *Nat’l Ass’n of Mfrs. v. U.S. Sec. & Exch. Comm’n*, No. MO:21-CV-18-DC, (W.D. Texas, Sept. 28, 2022).

<sup>60</sup> CCMR *supra* note 55.

rulemakings and even to other independent agencies that regulate the financial system. Such a policy, especially if it is applied generally by various agencies, could create significant uncertainty for market participants by undermining proper regulatory processes and the rule of law. It may erode market participants’ confidence that regulatory changes enacted by one administration will be consistently applied by subsequent administrations. Thus, as we argued in a prior statement,<sup>61</sup> the Committee’s view is that rules adopted by the SEC and other financial regulators should be enforced until they are changed through a new rulemaking that follows the APA’s public notice and comment process.

2) DOL’s inconsistent guidance on private equity investments by 401(k) plans

In June 2020, the DOL issued an “Information Letter” that addressed the permissibility of offering private equity (“PE”) fund investments as an option to participants in individual account retirement plans, including 401(k) plans, under the fiduciary standards of the Employee Retirement Income Security Act of 1974 (“ERISA”).<sup>62</sup> The Information Letter stated the DOL’s view that a fiduciary of such a plan may offer an asset allocation to PE investments consistent with ERISA’s fiduciary standards, provided the fiduciary properly evaluates the risks and benefits associated with such investments in light of the characteristics of the plan’s participants, and properly evaluates whether it has the skills, knowledge, and experience to make such determinations with respect to PE investments.<sup>63</sup>

However, on December 21, 2021, the DOL issued a “supplemental statement” (the “**Supplemental Statement**”)<sup>64</sup> indicating that the Information Letter applies only to fiduciaries that have experience evaluating PE investments for defined benefit plans with the assistance of a qualified fiduciary investment adviser.<sup>65</sup>

The Supplemental Statement thereby effects a narrowing of the scope of the Information Letter. The Information Letter does not expressly limit its scope to fiduciaries that have experience evaluating PE investments in a defined benefit plan context. The Supplemental Statement however cautions against applying the Information Letter outside this context. The Supplemental Statement thus effects a retroactive narrowing of the scope of prior guidance.

The effect of such retroactive amendments could be to reduce market participants’ confidence in the validity of similar regulatory pronouncements in the future. There is no basis for the DOL to narrow its prior guidance in this way. We therefore call on the DOL to rescind the Supplemental Statement.

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<sup>61</sup> *Id.*

<sup>62</sup> U.S. DEP’T OF LABOR, Information Letter 06-03-2020 (June 3, 2020), <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020>.

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

<sup>64</sup> U.S. DEP’T OF LABOR, Supplemental Statement on Private Equity in Defined Contribution Plan Designated Investment Alternatives (Dec. 21, 2021), <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020-supplemental-statement>.

<sup>65</sup> *Id.*

3) SEC expansion of the statutory definitions of “underwriter,” “dealer,” and “government securities dealer”

Two of the SEC’s recent rulemaking proposals would effect significant and unauthorized expansions of statutorily defined terms.

First, as part of its proposal on special purpose acquisition companies (“SPACs”)<sup>66</sup> the SEC would expand the statutory definition of “underwriter” under the Securities Act of 1933 to treat any underwriter of an offering of SPAC securities as an underwriter with respect to a subsequent acquisition by that SPAC (a “**de-SPAC**”) if the SPAC underwriter “takes steps to facilitate” or “otherwise participates (directly or indirectly) in” the de-SPAC transaction.<sup>67</sup> The underwriter of a SPAC offering would thus be potentially liable for inaccurate disclosures relating to a de-SPAC regardless of whether the SPAC underwriter agreed to act as underwriter for the de-SPAC.<sup>68</sup>

The SEC presents its proposed expansion as a mere “clarification” of the existing statutory definition. It explains that this clarification is necessary to “better motivate SPAC underwriters to exercise the care necessary to ensure the accuracy of the disclosure in these transactions.”<sup>69</sup>

This purported clarification is however in fact a significant and unauthorized expansion of a statutory term. This is evidenced by the fact that courts have on numerous occasions rejected the interpretation of “underwriter” on which the SEC’s purported clarification is premised, on the grounds that the definition – while broad – is intended to apply only to those who “play a role in the distribution of securities,” rather than “anyone associated with a given transaction.”<sup>70</sup> Indeed, as other commentators have noted, the structure of a de-SPAC transaction is such that it does not involve an underwriter, because it consists of a “direct issuance of securities by the issuer to the shareholders of the counterparty to the business combination” and not a purchase and subsequent distribution by an investment bank of the issuer’s securities.<sup>71</sup> The SEC’s action thus amounts to the use of a perceived regulatory imperative as grounds to exceed the bounds of a statute. Moreover, by casting its expansion of an existing statutory provision as a mere clarification, the SEC suggests that its interpretation applies retroactively. It thus presents a risk of liability to underwriters in SPAC transactions that occurred before the proposed rulemaking, who had no notice of the SEC’s interpretation of this term. It is important that U.S. financial regulatory agencies not seek or be perceived to be seeking avenues to expand their authority beyond statutory limitations. As we stated in our original comment letter,<sup>72</sup> we call on the SEC to withdraw this portion of its SPAC proposal.

<sup>66</sup> SEC, *supra* note 6.

<sup>67</sup> *Id.* at 29,463.

<sup>68</sup> See SIFMA, Letter Re. Special Purpose Acquisition Companies, Shell Companies, and Projections; File No. S7-13-22; Release Nos. 33-11048, 34-94546 (June 10, 2022), <https://www.sifma.org/wp-content/uploads/2022/06/SIFMA-Comment-Letter-on-SECs-SPAC-Proposal.pdf>.

<sup>69</sup> *Id.*

<sup>70</sup> *In re REFCO Inc. Securities Litigation*, 2008 WL 3843343 (S.D.N.Y. Aug 14, 2008); see also, *In re Lehman Brothers Mortgage-Backed Securities Litigation*, 650 F.3d 167 (2d Cir. 2011); *Federal Deposit Insurance Corp. v. First Horizon Asset Securities Inc.*, 443 F. Supp. 3d 505 (S.D.N.Y. 2020).

<sup>71</sup> SIFMA *supra* note 68.

<sup>72</sup> See CCMR, Comment Letter Re. File No. S7-13-22: Special Purpose Acquisition Companies, Shell Companies, and Projections (June 13, 2022), <https://www.capmksreg.org/2022/06/13/committee-submits-comment-letter-on-the-secs-proposal-on-spacs/>.

Second, the SEC’s proposal to further define “as a part of a regular business” as used in the statutory definitions of “dealer” and “government securities dealer” under the Securities Exchange Act of 1934 (the “**Exchange Act**”)<sup>73</sup> would defy the plain language of the Exchange Act and conflict with longstanding legal and regulatory interpretations of such terms.

As we intend to state more fully in our forthcoming comment letter on this proposal, the SEC’s proposal would depart radically from an established framework whereby the courts and the SEC have identified various activities and factors germane to a firm’s designation as a dealer, without one factor ever being determinative. The proposal would instead create four irrebuttable “tests,” each of which could alone trigger dealer registration requirements. The *quantitative* threshold, which incorporates no substantive analysis of the nature of a firm’s trading activity, represents a particularly significant departure from precedent, and an idea that the SEC has itself rejected in previous no-action letters.<sup>74</sup> Moreover, such a threshold is unsupported by the language of the Exchange Act, which refers to “buying *and* selling” securities. A dealer does not trade on only one side of the market, and courts have made clear that the word “and” indicates a degree of “temporal proximity,”<sup>75</sup> which implies that there must be temporal proximity between a dealer’s purchases and sales. However, the SEC’s quantitative test would impose dealer registration requirements on an investor whose “trading volume” in government securities in four of the past six months exceeded \$25 billion, even if 99% of its orders were buys and only a single order to sell was entered each month. This new definition bears little resemblance to the dealers that Congress, the courts, and the SEC have traditionally sought to regulate and is at odds with the statutory text.

We therefore call on the SEC to defer finalizing this proposal until it has publicly released a full analysis of the proposal’s statutory foundations and its costs and benefits.

4) Reversal of regulatory interpretation and inadequate notice and comment related to applying Rule 15c2-11 to fixed income securities and amendments to Rule 144A without any notice and comment process

Amended Rule 15c2-11 requires dealers to obtain and review certain issuer financial information before publishing a quotation in an over-the-counter (“**OTC**”) security with respect to the issuer’s securities in any quotation medium other than a national securities exchange, and that this financial information be publicly available.<sup>76</sup> The rule is designed to protect retail investors in the more speculative OTC equity markets. In a no-action letter issued in September 2021, the SEC indicated that it intended to begin enforcing Rule 15c2-11 with respect to debt securities after January 3,

<sup>73</sup> SEC, *supra* note 4.

<sup>74</sup> SEC, *SEC Staff No-Action Letter re: United Trust Company* (Sept. 6, 1978) (“the level of a firm’s activity with respect to . . . securities is not the measure of whether it is ‘engaged in the business’ of buying and selling . . . securities for its own account”); SEC, *SEC No-Action Letter re: US Savings Association of Texas* (Apr. 2, 1987) (discussing the Congressional record).

<sup>75</sup> See, e.g., *Lake Bldg. Prods., Inc. v. Sec’y of Labor*, 958 F.3d 501, 505 (6th Cir. 2020).

<sup>76</sup> 17 CFR § 240.15c2-11. The requirement that the furnished information be publicly available came into effect on September 28, 2021. See SEC, *Publication or Submission of Quotations Without Specified Information*, Exchange Act Release No. 89891 (Sept. 16, 2020), 85 FR 68124 (Oct. 27, 2020).

2022.<sup>77</sup> On December 16, 2021, the SEC released a second no-action letter which outlined a three-phase approach to enforcing Rule 15c2-11 to a variety of fixed income securities.<sup>78</sup>

Under the details of the second no-action letter, issuers of debt securities under Rule 144A will be required to make financial information available to the public if they want dealers to be able to publish quotes for their securities. In the fifty years since Rule 15c2-11 was promulgated in 1971, the SEC has applied the rule to equity securities only and has not applied the rule to debt securities, including debt securities offered under Rule 144A. The SEC’s reversal departs from 50 years of regulatory practice for Rule 15c2-11, and effectively changes the disclosure requirements for Rule 144A via a no-action letter issued with respect to an unrelated rulemaking.<sup>79</sup> The change was thus not preceded by a formal notice and comment rulemaking process dedicated to consideration of amendments to the disclosure requirements for Rule 144A.

The Rule 144A debt market is exclusively for qualified institutional buyers (“QIBs”). These investors typically access an issuer’s financial information upon request or through a non-public, password protected website. However, the SEC’s December 2021 Rule 15c2-11 no-action letter requires financial information to be made available to members of public who are not QIBs. As other commentators have noted, this change will make it more difficult and expensive for many private issuers that do not wish to and would not otherwise make such public disclosures to raise debt capital.<sup>80</sup> Because there was no public comment period, market participants were not able to comment on the importance of these issues, including the cost-benefit analysis of requiring an issuer to make financial information available to the investing public who, by and large, cannot purchase their securities. Nor was a transparent economic analysis of the consequences of the change conducted. Although Rule 15c2-11 does not carve out debt securities, a regulator’s application of a *de facto* exclusion over 50 years obviously conditions the expectations of market participants. Altering such a long-standing and significant practice without a transparent analysis of the rationale and consequences of the change increases the degree of regulatory uncertainty for market participants in U.S. financial markets. Consistent with SEC Commissioner Peirce’s statement, the SEC should submit its novel application of Rule 15c2-11 to fixed income securities to the public notice and comment rulemaking process.<sup>81</sup>

<sup>77</sup> See Letter from Josephine Tao, Assistant Director, Office of Trading Practices, Division of Trading and Markets to Racquel Russell, Senior Vice President and Director of Capital Markets Policy, Office of the General Counsel, FINRA (Sept. 24, 2021) (Temporary Staff No-action Letter Regarding Rule 15c2-11 and Fixed Income Securities), <https://www.sec.gov/files/rule-15c2-11-fixed-income-securities-092421.pdf>; Letter from Josephine Tao, Assistant Director, Office of Trading Practices, Division of Trading and Markets to Racquel Russell, Senior Vice President and Director of Capital Markets Policy, Office of the General Counsel, FINRA (Dec. 16, 2021) <https://www.sec.gov/files/fixed-income-rule-15c2-11-nal-finra-121621.pdf>.

<sup>78</sup> SEC, Letter Re. Amended Rule 15c2-11 in Relation to Fixed Income Securities (Dec. 16, 2021), <https://www.sec.gov/files/fixed-income-rule-15c2-11-nal-finra-121621.pdf>.

<sup>79</sup> The no-action letters were issued with respect to amendments to the operational and systems requirements under Rule 15c2-11. See SEC, *Publication or Submission of Quotations Without Specified Information*, 85 FR 68124, <https://www.federalregister.gov/documents/2020/10/27/2020-20980/publication-or-submission-of-quotations-without-specified-information>.

<sup>80</sup> See SIFMA, RULE 15C2-11, <https://www.sifma.org/explore-issues/rule-15c2-11/>.

<sup>81</sup> Statement by Commissioners Peirce and Roisman on Chair Gensler’s Regulatory Agenda (Dec. 14, 2021), <https://corpgov.law.harvard.edu/2021/12/14/statement-by-commissioners-peirce-and-roisman-on-chair-genslers-regulatory-agenda/>.



**Conclusion**

As we noted at the outset, transparent regulation that is informed by public input and consistently enforced and interpreted is a pillar of U.S. financial markets. In this statement the Committee has identified 10 significant and recent actions by U.S. financial regulators that go against this spirit of transparency and consistency in rulemaking, supervision, and enforcement. In each case we have called on the relevant regulator to take a specific remedial action. However, these examples taken together also evince a concerning underlying pattern that threatens the preeminence of U.S. financial markets. To conclude we therefore repeat our call for U.S. financial regulators to restore their commitment to the norms of transparency and consistency and for a comprehensive review by the President's Working Group on Financial Markets and appropriate congressional committees of the trend discussed herein.





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