TREASURY REPORTS CONTINUE TO INFORM DODD-FRANK REFORM EFFORTS

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By: Daniel F. C. Crowley, Bruce J. Heiman, William A. Kirk, Karishma Shah Page, Eric A. Love, Dean A. Brazier

On October 26, 2017, the U.S. Department of the Treasury (the "Treasury") released a report entitled "A Financial System That Creates Economic Opportunities: Asset Management and Insurance," the third in a series of reports that President Trump's Executive Order 13772 on Core Principles for Regulating the U.S. Financial System (the "Core Principles") requires Treasury to issue about potential ways to legislatively and administratively reform the U.S. financial system, consistent with the Core Principles. Earlier this month, Treasury released its second such report, which outlined recommendations concerning the capital markets. Treasury's first report on banks and credit unions was released in June 2017 (*See* K&L Gates Alert: Dodd-Frank Reform; What Comes Next?), and one additional report is expected to be released in the near future. Treasury's recommendations are likely to inform the efforts currently underway in Congress to advance financial regulatory reform legislation. This alert highlights a number of notable recommendations contained in the asset management and insurance report, as well as the capital markets report.

ASSET MANAGEMENT AND INSURANCE:

The Treasury recommendations for regulating the asset management industry are mostly focused on Securities and Exchange Commission ("SEC") and Commodity Futures Trading Commission ("CFTC") rulemaking activities, with a primary emphasis on the SEC. The most notable recommendations address systemic risks and stress testing, interagency coordination, disclosure reform, and international engagement. Treasury also revisited its review of the Volcker Rule and made more recommendations to accompany those made in Treasury's first report.

- Systemic risk and stress testing: Treasury implicitly indicates that a one-size-fits-all approach to managing systemic risk is not appropriate for asset management. Treasury instead calls for regulators to weigh the specific risks created by the various products and services offered by asset managers and to tailor regulations to those products and services. This tailored regulatory model differs from the existing entity-based model. Treasury also calls for SEC leadership on regulating systemic risks in the asset management industry.
- Interagency coordination: Treasury recommends that the CFTC exempt certain investment advisers from CFTC regulation when they are also registered with the SEC. Treasury makes a similar recommendation for certain private funds.
- Disclosure recommendations: These are consistent with the themes contained in the Treasury reports that have already been released. Treasury continues to push for a reduction in duplicative or unnecessary disclosures and for the creation of consistency and efficiency in an industry that has multiple regulatory agencies with divided oversight. Moreover, Treasury recommends a narrower definition of "banking entity"

in the Bank Holding Company Act in order to tailor the Volcker Rule's application to those entities that pose the targeted risks.

- Insurance industry regulation: Treasury's recommendations will likely require coordination among state regulators, the Federal Reserve Board, and Treasury to accomplish these objectives. Similar to the asset management recommendations, Treasury places initial emphasis on managing systemic risks within the industry. Additionally, Treasury makes the same recommendation for moving from an entity-based model to a model that considers the risks posed by specific insurance products and services. Another notable recommendation is enhanced regulatory coordination between state and federal regulators.

CAPITAL MARKETS:

Securities

Treasury recommends the repeal of a number of SEC disclosure requirements provisioned under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), including on pay-ratio (Section 953 (b)), conflict minerals (Section 1502), resource extraction (Section 1504), and mine safety (Section 1503). If Congress does not act to repeal the provisions, Treasury recommends that the SEC consider exempting smaller reporting companies and emerging growth companies ("EGCs") from these provisions. The report also contains a recommendation that the SEC move forward with a proposal to amend Regulation S-K, consistent with the SEC staff recommendation that was required by the "Fixing America's Surface Transportation Act." In the capital markets report, Treasury calls for the SEC to finalize its proposal that would eliminate certain SEC disclosure requirements that overlap with financial statement disclosures that are required, pursuant to generally accepted accounting principles, by the Financial Accounting Standards Board.

In addition, Treasury expresses support for substantial revision of the $2,000 holding requirement for shareholder proposals under SEC Rule 14a-8, and for revisions to the resubmission thresholds for repeat proposals. It also recommends that the SEC continue to comment on the issue of whether offering documents furnish sufficient disclosure of dual class stock and its impact on shareholder voting. Notably, Treasury also favors further study of the role that proxy advisory firms play in the securities markets.

Among its other notable recommendations are modifying the definition of "accredited investor" to broaden the pool of "sophisticated" investors, as well as allowing companies other than EGCs to "test the waters" with possible institutional accredited investors or qualified institutional buyers. It also includes a recommendation that the SEC reduce complexity in the U.S. equity markets by reviewing whether there should be harmonization of order types between exchanges and alternative trading systems.

Derivatives

The Treasury report on the capital markets contains recommendations that would have implications for both U.S. and international derivatives markets. Regarding the United States, Treasury recommends that the CFTC and SEC prioritize an effort to jointly harmonize their derivatives rulemakings under Title VII of the Dodd-Frank Act. Treasury also proposes that the CFTC keep the *de minimis* registration threshold for swap dealers at $8 billion and recommends subjecting future revisions to the threshold to a formal rulemaking process. Recently, the CFTC issued an order indicating that the *de minimis* registration threshold will remain at $8 billion until December 2019, instead of falling to $3 billion at the end of 2018 as scheduled. In recent testimony before the House Agriculture Committee, CFTC Chairman J. Christopher Giancarlo signaled that he intends to work to resolve this issue with his fellow CFTC Commissioners during the first half of 2018. In the capital markets report, Treasury also calls for the CFTC to finalize its pending position limits rule, with an emphasis on deterring fraud and market manipulation.

On the international front, the report includes a recommendation that the CFTC and SEC provide greater clarity regarding the cross-border nature of their regulations and, where possible, assure that their rules are compatible with those in other countries. It also recommends heightened regulatory harmonization efforts and "meaningful" substituted compliance initiatives between the CFTC and regulators in other countries.

WHAT HAPPENS NEXT?

Discussions continue in Congress about the appropriate scale and scope of financial regulatory reform legislation, and the Treasury reports can be expected to influence these efforts. The reports come as Senate Banking Committee ("SBC") Chairman Mike Crapo (R-ID) and Ranking Member Sherrod Brown (D-OH) consider input received from the public on legislative proposals to promote economic growth, as part of their effort to craft a bipartisan regulatory reform bill. In the near term, the SBC is expected to continue putting together its reform proposal, while convening hearings that will also inform the thinking of SBC members.

In June 2017, the House passed H.R. 10, the "Financial CHOICE Act of 2017" (the "FCA"), a bill introduced by House Financial Services Committee Chairman Jeb Henslarling (R-TX) to comprehensively reform the Dodd-Frank Act. The bill, which passed along party lines, includes a number of issues addressed in the Treasury reports that have been released to date. However, the FCA is not expected to pass the Senate in its current form. (*See* K&L Gates Alerts: Financial Choice Act Is Expected to Move to the House Floor; and The Financial CHOICE Act 2.0, Legislative Text Revealed.) If the Senate passes a reform bill, the FCA could serve as a marker for House Republicans' negotiations in a conference committee to reconcile the differences between the House and Senate bills. It also remains possible that certain elements of the Treasury reports and/or the FCA could advance as stand-alone measures or be included in legislative vehicles such as appropriations bills that must be passed before the end of the year.

CONCLUSION

Although there appears to be some agreement emerging among Members of Congress on both sides of the political aisle about the need to provide targeted regulatory relief to small- and medium-sized financial institutions, comprehensive reform of the Dodd-Frank Act is expected to be an incremental, multi-year process. As the contours of the Senate's legislative proposal continue to develop, the K&L Gates global financial services policy team is available to assist interested stakeholders to meaningfully influence the debate in furtherance of their unique policy goals.

KEY CONTACTS

DANIEL F. C. CROWLEY
PARTNER

WASHINGTON DC
+1.202.778.9447
DAN.CROWLEY@KLGATES.COM

BRUCE J. HEIMAN
PARTNER

WASHINGTON DC
+1.202.661.3935
BRUCE.HEIMAN@KLGATES.COM

WILLIAM A. KIRK
PARTNER

WASHINGTON DC
+1.202.661.3814
WILLIAM.KIRK@KLGATES.COM

KARISHMA SHAH PAGE
PARTNER

WASHINGTON DC
+1.202.778.9128
KARISHMA.PAGE@KLGATES.COM

