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Regulatory Alert

Financial Services Regulatory Insight Center

Treasury Report on Capital Markets

The Department of the Treasury recently released its report on "ways to streamline and reduce burden in capital markets regulation." The report is the second in a planned series of four reports analyzing the U.S. financial services regulatory framework and outlining recommendations to better align the current regulatory requirements with the "Core Principles." In general, the recommendations in the "Capital Markets Report" are aimed at increasing small business and investor access to the capital markets, recalibrating rules to promote risk management, and rationalizing the regulatory structure.

Recommendation

Recommendations in this report cover debt, equity, commodities, and derivatives markets, central clearing and other operational functions. Many build on themes outlined in the Treasury's first report, which focused on the banking industry. These reforms can be carried out largely through agency action rather than legislation – increasing the likelihood of implementation more expediently and more closely correlated with Treasury's suggestions.

The report contains ninety one recommendations, seven of which would require legislation. Key recommendations include:

- **Finalizing and harmonizing the swaps-related rules** of the Securities and Exchange Commission (**SEC**) and the Commodity Futures Trading Commission (**CFTC**), including the cross-border scope of those rules. The agencies are encouraged to develop an "alternate compliance regime," such as substituted compliance or mutual recognition as appropriate, where harmonization is not possible either domestically or with non-U.S. jurisdictions. The report highlights that the SEC has proposed but not yet finalized "several critical rulemakings" for security-based swaps. With regard to margin requirements for uncleared swaps, Treasury recommends easing certain requirements related to transactions between affiliates, timeframes for margin settlement, and the scope of financial end-users. Notably, Treasury argues against a merger of the SEC and CFTC, suggesting that it would not appreciably improve the system.
- **Maintaining** the CFTC swap dealer **de minimis registration threshold** at **$8 billion, and** subjecting any **future changes** to the threshold to a **formal rulemaking** and public comment **process**.
- **Increasing regulatory oversight** of systemically important **Financial Market Utilities** (FMUs) and **central counterparties** (CCPs). Treasury notes that because of the role FMUs play in the capital markets and their increasing interconnectivity with financial institutions, "heightened regulatory and supervisory scrutiny" is necessary. It recommends U.S. regulators "bolster resources" for the supervision and regulation of systemically important FMUs and

the CFTC allocate greater resources for supervision of CCPs. Treasury also recommends the CFTC expand its future CCP stress testing exercises to incorporate additional products, different stress scenarios, liquidity risk, and operational and cyber risks (CFTC recently completed its first exercises).

— Improving policy decision making by **avoiding the imposition of new requirements through no-action letters, interpretations, or other form of guidance and pursuing** rulemaking through the enhanced use of regulatory **cost-benefit analysis** and **public notice and comment**. To this end, the report states that the agencies should take steps to ensure that guidance is not being used excessively or unjustifiably to make substantive changes to rules without going through the notice and comment process. Notably, these recommendations will increase the time and costs associated with new policy actions.

— **Pulling back** the bank regulatory agencies' **capital and liquidity standards** to encourage **securitizations** and increase credit availability, including recommendations for regulators to: align capital requirements for securitized products with the capital requirements for the underlying asset; allow certain high-quality securitized obligations to qualify as high-quality liquid assets under the liquidity standards; and expand the qualifying underwriting exemptions related to risk retention. The securitization markets were severely diminished after the financial crisis and the recommendations are intended to encourage the redevelopment of the markets. Treasury's first report addressed mortgage securitizations.

— **Targeting specific** market structure **issues**, such as: i) increasing investor access to the capital markets through revision of the "accredited investor" definition; ii) increasing crowdfunding limits from $1 million to $5 million; iii) reviewing whether exchanges and alternative trading systems should harmonize their order types; and iv) promoting rules to improve liquidity for less actively traded stocks.

Closing Thoughts

Consistent with its "Banking Report," Treasury's Capital Markets Report focuses on efforts to address the "effectiveness and efficiency" of the financial services regulatory framework. Many of the recommendations are actually not new concepts, having been put forward in various forms since the enactment of Dodd-Frank. And in contrast to the expectation that Treasury would advocate wholesale de-regulation, the Capital Markets Report contains some notable instances where the regulators are encouraged to complete and implement the requirements of Dodd-Frank, and to increase regulatory oversight (as with FMUs and CCPs).

The degree to which the recommendations may be executed is somewhat uncertain as Treasury does not have direct regulatory authority over the financial markets or most of the relevant regulatory agencies. Yet, with endorsements from the Chairs of the SEC and the CFTC, the reports could be viewed as a strategic plan for future adjustments to capital markets regulation.

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