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INSIGHT

Second Treasury Report on Regulatory Relief: Capital Markets

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October 19, 2017

On October 6, 2017, the Department of the Treasury issued a report, *A Financial System That Creates Economic Opportunities: Capital Markets,* that primarily examines the regulation of debt, equity, commodities, and derivatives markets. The report is the second of a series written in accordance with Executive Order (E.O.) 13772, which was issued by the President on February 3, 2017.

The capital markets report provides 91 policy recommendations, the majority of which could be implemented by the primary regulators of U.S. capital markets: the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), state securities regulators, and Self-Regulatory Organizations (SROs). Notwithstanding the nonbinding nature of the recommendations, both SEC Chairman Jay Clayton and CFTC Chairman J. Christopher Giancarlo have publicly applauded the report. The report states that nine of the 91 Treasury recommendations would require congressional action.

Report Highlights

Treasury's recommendations, which fall into several categories, aim to enhance the following:

- **Access to capital** for companies, especially small and growing businesses, through reduction of regulatory burdens and improved market access. The report identifies scaled regulatory approaches and highlights new tools, namely Regulation A Tier 2 and crowdfunding. It also identifies regulations to modify certain shareholder rights.
- **Secondary markets** in equity and debt. The report recommends policies to facilitate liquidity, including consolidating liquidity for thinly traded stocks; reevaluating tick size; potentially harmonizing order types for various exchanges and alternative trading systems (ATS); streamlining public disclosure under Regulation ATS; and revisiting the market data rules and order protection rules under Regulation National Market System.

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- **Regulatory relief for securitized products** for lending and risk transfer. The report, which asserts that the Dodd-Frank Act (DFA) has created disincentives for securitization, calls for a roll back of certain regulations and suggests that Congress designate a lead agency from the six agencies promulgating the Credit Risk Retention rules.
- **Derivatives** regulation for market efficiency and risk mitigation. Treasury suggests SEC and CFTC harmonize their rulemaking in Title VII of DFA, including swaps regime, cross-border coordination, swap data reporting, central clearing capital treatment, and other areas.
- **Risk management for central counterparties and other financial market utilities (FMUs)**. Treasury recommends improving oversight of systemically important FMUs and suggests the regulators finalize a framework for FMU recovery or resolution.
- **Regulatory structure and processes**. Treasury recommends modernizing the regulatory structure through coordination between SEC, CFTC, and banking regulators. It also suggests modifying the regulatory process through the incorporation of more transparency, economic analysis, and the policy impact analysis on small entities. A comprehensive review of SROs is also recommended.
- **International standard setting** to generate a "level playing field" for U.S. interests internationally.

Policy Roles

Although the report presents an extensive list of recommendations, the majority of them could be implemented by financial regulators without congressional involvement.

The nine recommendations that would require congressional action include the following:

- **Access to capital.** Treasury recommends repeal of what it calls "non-material" disclosures in DFA provisions on conflict minerals, mine safety, resource extraction, and pay ratio. These provisions are said to have imposed requirements to disclose information that is not material to the reasonable investor for making investment decisions. In addition, Treasury recommends the time a company may be considered an Emerging Growth Company (EGC) to be extended to up to 10 years, among other requirements. The extension would allow EGCs to be exempt from certain regulations, including Section 404(b) of the Sarbanes-Oxley Act, for longer periods.
- **Reiteration of three recommendations** from the Treasury's first report. Written in accordance with E.O. 13772 concerning the regulation of banks and credit unions, the recommendations modify regulations relating to repo financing, secondary market liquidity, and credit risk retention.
- **SEC and CFTC operations.** The recommendations would harmonize rulemaking of the two agencies, modify certain DFA restrictions, and provide the CFTC with increased authority in certain swaps clearing requirements and allocate more resources toward FMU supervision.

Furthermore, many of the 91 recommendations overlap existing proposals that have already received agency and/or congressional attention:

- **Agency-proposed rules.** Some of the recommendations align with existing agency agendas and are already part of the agency rulemaking process. For example, Treasury recommends that the SEC amend Regulation S-K, which specifies the disclosure requirements for public companies. The SEC has been studying the issue since 2013, and it voted to amend Regulation S-K on October 11, 2017.

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- **Financial CHOICE Act (FCA) provisions repealing portions of the DFA**. The FCA passed the House on June 8, 2017. Certain provisions in FCA would produce changes similar to those recommended by the Treasury, including SEC-CFTC harmonization of the derivatives rules, and the repeal of non-material DFA mentioned above.
- **Standalone bills**. A number of spinoffs from the FCA have been introduced as standalone bills for consideration. These standalone bills also overlap Treasury recommendations. For example, the Fostering Innovation Act of 2017 proposes the lengthening of the time a company could be considered an EGC. This bill, which was ordered to be reported by the House Financial Services Committee on October 12, 2017, directly relates to a similar FCA provision and the Treasury EGC recommendation mentioned above.

Support and Criticism

The report states that the United States has experienced the slowest economic recovery of the post-war period. Proponents believe the suggested actions could fuel economic growth. Treasury Secretary Steven Mnuchin asserts that, by streamlining the regulatory system, the capital markets could generate economic growth and foster small business development. Certain trade groups echo this thought. Rob Nichols from American Bankers Association states that the recommendations, if implemented, would make it easier for businesses to raise capital. He also argues that the recommendations promote "effective" supervision.

The report also faces criticism for its perceived deregulatory approach. Representative Maxine Waters states that the report is a "blueprint for dismantling" DFA reforms. Others are questioning the linkage between economic growth and deregulation. For example, Mike Calhoun from the Center for Responsible Lending states that he is skeptical of claims that regulations stifle the economy and thinks the Treasury recommendations are the wrong prescription for economic growth.