Banking & Financial Services ELECTRONICALLY REPRINTED FROM SEPTEMBER 2014

Swaps Provisions of Dodd-Frank Act: Cost-Benefit Analysis and Judicial Review

By Dan M. Berkovitz

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] (the Dodd-Frank Act or the Act) established a comprehensive new regulatory framework for the previously unregulated swaps and security-based swaps markets. The Dodd-Frank Act directed the Commodity Futures Trading Commission (CFTC or commission) and Securities and Exchange Commission (SEC) to write a variety of rules to reduce the systemic risks presented by the derivatives markets and to increase the transparency of those markets. The new rules were to provide for the mandatory clearing for standardized swaps and security-based swaps; the trading of those standardized instruments on transparent, regulated facilities; registration, capital requirements, and business conduct standards for dealers and other large market participants in such financial instruments; comprehensive reporting requirements; and enhanced enforcement authorities.

The CFTC has largely completed its required rulemakings under the Act and the swaps market is operating under the new regulatory framework.[2] More than 100 swap dealers have been registered, interest rate and credit default swaps are subject to mandatory clearing and trading, and swaps routinely are being reported to swap data repositories. To date, only one CFTC final rule, imposing limits on speculative positions, has been successfully challenged.[3]

One of the most controversial aspects of the CFTC's Dodd-Frank rulemakings has been the agency's consideration of the costs and benefits of its proposed and final rules. During the rulemaking process critics asserted that the CFTC failed to conduct sufficiently rigorous quantitative and economic analyses of its rules or of alternatives to the proposed or final regulations and failed to follow the principles for cost-benefit analyses that apply to executive branch agencies pursuant to presidential executive orders.

Section 15(a) of the Commodity Exchange Act (CEA) requires that before promulgating any regulation under the CEA or issuing an order the commission "shall consider the costs and benefits of the action."[4] It further specifies five "considerations" that the costs and benefits shall "be evaluated in light of": protection of market participants and the public; the efficiency, competitiveness and financial integrity of futures markets; price discovery; sound risk management practices; and other public interest considerations.[5] The CFTC has interpreted this provision not to require quantitative analysis, or to make any findings that the benefits of the action outweigh the costs.

The concerns regarding the adequacy of the CFTC's consideration of costs and benefits in the Dodd-Frank rulemakings significantly increased in the summer of 2011, just as the CFTC was moving toward issuing final regulations, when the US Court of Appeals for the District of Columbia Circuit (DC Circuit), in *Business Roundtable v. SEC*, overturned the SEC's "proxy access rule" on the grounds that the SEC had not adequately considered the economic consequences of the rule.[6] *Business Roundtable* was the fourth recent case in which the DC Circuit invalidated an SEC rule on the grounds of inadequate economic analysis.[7] Both critics and supporters of the CFTC's Dodd-Frank rulemakings questioned whether any of the SEC or CFTC Dodd-Frank rulemakings could survive judicial review under the standards set forth in *Business Roundtable*.

As a result of public comment, congressional criticism, inspector general reports, and the DC Circuit's decisions overturning several recent SEC rulemakings, in the midst of the Dodd-Frank rulemakings the CFTC significantly upgraded the manner in which it

Dan M. Berkovitz is a partner in the Futures and Derivatives practice at WilmerHale, Washington, DC. Mr. Berkovitz served as General Counsel of the CFTC from 2009–2013. From 2011–2013, he also served as the CFTC's Deputy Representative to the Financial Stability Oversight Council. Mr. Berkovitz also is an adjunct professor at Georgetown University Law School, where he teaches energy trading and regulation.

considered the costs and benefits of its rules. These upgrades included greater quantification of costs and benefits, to the extent reasonably feasible, more detailed consideration of alternatives, and greater responsiveness to public comments. For largely similar reasons the SEC upgraded its procedures for its economic analyses and consideration of costs and benefits.

Breaking with its prior string of decisions rejecting SEC rulemakings, the DC Circuit has recently upheld two Dodd-Frank rulemakings, one issued by the CFTC and the other by the SEC. In both *Investment Co. Inst. (ICI) v. CFTC* and *National Ass'n of Manufacturers (NAM), v. SEC* the DC Circuit articulated a deferential standard of review for agency rulemakings, including agency consideration of costs and benefits.[8] As a general matter, these cases indicate that the current CFTC and SEC approaches to the consideration of costs and benefits and economic analysis can be sufficient to survive judicial review in the DC Circuit.

This article first summarizes the regulation of swaps under the Dodd-Frank Act and the way the CFTC has implemented that Act. It then describes the issues concerning the CFTC's consideration of costs and benefits in those rulemakings. It examines the evolution of the case law in the DC Circuit regarding the consideration of costs and benefits in financial agency rulemakings. The article concludes with a discussion of the implications of the recent *ICI* and *NAM* cases with respect to potential future challenges to rulemakings by financial regulatory agencies.[9]

Regulation of Swaps under Dodd-Frank

Unregulated derivatives were widely viewed as one of the prime causes of the financial crisis in 2008. The Financial Crisis Inquiry Commission found "the existence of millions of derivative contracts of all types between systemically important financial institutions—unseen and unknown in this unregulated market—added to uncertainty and escalated panic, helping to precipitate government assistance to those institutions."[10]

Title VII of the Dodd-Frank Act was enacted to reduce the systemic risk presented by these markets, improve market integrity, and increase market transparency. Title VII provides two main approaches to the accomplish these objectives: the first is the regulation of large participants in the swap markets presenting the greatest systemic risks, that is, swap dealers and other major market participants with large swap books or exposures; and the second is the regulation of transactions in swaps.

Congress divided the authority over the derivatives market along preexisting jurisdictional lines between the CFTC and the SEC. Subtitle A of Title VII provides the CFTC with the authority and responsibility for regulating the swaps market. Subtitle B provides the SEC with parallel authority and responsibility for regulating the security-based swaps market.[11]

The Dodd-Frank Act requires the registration of "swap dealers" and "major swap participants (MSPs)."[12] The statute generally directed the CFTC to promulgate "business conduct standards" for registered swap dealers and MSPs to prevent fraud, manipulation, and other abusive practices, provide for the diligent supervision of the business of the registered entity, ensure adherence to applicable position limits, and such other requirements as the commission determines to be appropriate.[13] The statute established specific business conduct standards for registered entities to develop and implement risk management programs; establish "back office" procedures for swap transactions; keep records of transactions; report transactions to swap data repositories (SDRs) or, if no SDR is available, to the regulators; provide appropriate disclosure and documentation when entering into swap transactions with counterparties; and "communicate in a fair and balanced manner based on principles of fair dealing and good faith."[14] The statute applies heightened business conduct standards when a swap dealer or MSP is transacting with "special entity" counterparties, which the statute defines as federal, state, or local governmental agencies, pension funds, and endowments.[15]

Bank swap dealers and MSPs must meet minimum capital standards and margin (initial and variation) requirements for uncleared swaps that are established by the prudential regulators. Swap dealers and MSPs that are not banks must meet capital requirements and margin requirements for uncleared swaps that are established by the CFTC.[16]

With respect to the regulation of markets, the Dodd-Frank Act directed the CFTC to determine

which swaps should be subject to mandatory clearing.[17] When a class of swaps is determined to be subject to mandatory clearing, then generally any such swap within that class of swaps must be cleared on a derivatives clearing organization (DCO) that is either registered with the CFTC or exempt from registration.[18] Nonfinancial end-users that enter into swaps to hedge or mitigate commercial risk are exempt from the clearing requirement.[19]

Swaps that are required to be cleared must be traded on or through a designated contract market (DCM), that is, a futures exchange, or swap execution facility (SEF), unless no DCM or SEF makes the swap available to trade.[20] All swaps, cleared or uncleared, must be reported to a swap data repository.[21] Additionally, all such swaps must be publicly reported "as soon as technologically practicable."[22]

The Dodd-Frank Act also established "core principles" for the registration and operation of the new swaps market infrastructures mandated by the Act—SDRs for the reporting of swap data, and SEFs for the execution of swaps.[23] The Act also revised the core principles for existing market infrastructures—DCOs and DCMs—to facilitate the clearing and trading of swaps on or through those facilities, respectively.[24]

The Dodd-Frank Act strengthened the CFTC's enforcement authorities in several respects. First, Congress provided the CFTC with new authority to prevent manipulation, modeled after the SEC's authority in Section 10(b) of the Securities Exchange Act, to make it easier for the CFTC to prove manipulation. The new authority prohibits the use of, or attempt to use, "any manipulative or deceptive device or contrivance" in connection with any swap, futures contract, or the contract of sale of any commodity interstate commerce.[25]

The Act also creates a new violation for "disruptive trading practices," which are defined as the violation of bids and offers, the intentional or reckless disregard for the orderly execution of transactions during the closing period, or "spoofing," which is bidding or offering with the intent to cancel the bid or offer before execution.[26] The new "Eddie Murphy" provision prohibits the use of nonpublic government information prior to its official release in connection with the purchase or sale of a futures contract, option, or swap.[27] The Act also establishes a whistleblower fund and protections for whistleblowers who report violations of the CEA.[28]

Congress provided for the cross-border application of the new swaps provisions by adding new Section 2(i) to the CEA.[29] Section 2(i) provides that the swaps provisions of the CEA do not apply to activities outside the United States "unless such activities have a direct and significant connection with activities in, or effect on, commerce of the United States," or "contravene such rules or regulations as the Commission may [promulgate] as are necessary or appropriate to prevent the evasion of any provision of [the Dodd-Frank Act]."

The Dodd-Frank Act expanded the CFTC's speculative position limits regime to apply to swaps in addition to futures contracts.[30] It directed the CFTC to set position limits for futures contracts and options on futures contracts for physical commodities other than excluded commodities (that is, agricultural, energy, and metal commodities) "as appropriate," and in accordance with the standards for the commission's preexisting authority to set position limits.[31] The CFTC must set the new limits for the spot month, individual months, and aggregate limits for all months combined.[32] The CFTC must also simultaneously establish position limits for swaps that are "economically equivalent" to the futures and options contracts for which it sets any new limits.[33] As under existing law, bona fide hedging transactions are exempt from these position limits.[34]

CFTC Implementation of Dodd-Frank

Over an approximate three-and-a-half year period following the enactment of the Dodd-Frank Act, the CFTC finalized 68 final rules, orders, and guidance documents.[35] Nearly all of the statutory requirements have been implemented, and many of these regulations became effective following the effectiveness of the joint CFTC-SEC rulemaking to further define the terms "swap" and "security-based swap" in October 2012.[36] Beginning in the fall of 2012, swap dealers and MSPs were required to register and, upon registration, became subject to the business conduct standards.[37] Registration also triggered the phase-in of swap data reporting.[38] As of August 2014, 102 swap dealers and two MSPs were provisionally registered.[39]

In December 2012, the CFTC issued final determinations to provide for the mandatory clearing of certain

interest rate swaps and index credit default swaps.[40] These clearing mandates became effective for swap dealers and MSPs in March 2013 and were phased in for other entities over the following six months.[41]

Twenty-two SEFs are temporarily registered with the CFTC.[42] In late 2013, five SEFs filed with the CFTC proposed determinations that certain classes of these interest rate swaps and index CDS were "available to trade."[43] The CFTC approved these proposed determinations in January 2014, and the mandatory trading requirement for these interest rate swaps and index CDS became effective in February 2014.[44]

Swap data reporting is well underway. Four SDRs are provisionally registered.[45] More than $400 trillion in aggregate outstanding notional value of swaps are being reported to the various SDRs.[46]

In July 2013, the commission issued final guidance regarding the cross-border application of the swaps provisions of the Dodd-Frank Act under CEA section 2(i) (Cross-Border Guidance).[47] The Cross-Border Guidance defines a "U.S. person" for purposes of the guidance, and states the commission generally would consider that swap transactions with US persons have the requisite "direct and significant" connection to US commerce to be subject to the swaps provisions of the Dodd-Frank Act. The document further provides guidance as to the circumstances in which foreign branches and overseas affiliates of US persons would also be subject to the swaps provisions of the Act.

The commission provides guidance for both US persons and non-US persons as to which transactions (that is, involving US or non-US persons) should be counted in determining whether they have exceeded the threshold for swap dealer or MSP registration, including when to also include the notional value of swaps entered into by affiliates. For both US and non-US persons that are registered as swap dealers or MSPs, the commission provides guidance as to which of the Title VII requirements apply to their transactions with different types of counterparties.[48] The guidance also addresses which requirements apply when neither counterparty is a swap dealer or MSP and one or both of the counterparties is a non-US person.[49]

The commission guidance also establishes a process of "substituted compliance" whereby an entity may comply with the rules of its home jurisdiction as a substitute for compliance with the CFTC's rule or the requirements of the Dodd-Frank Act.[50] For an entity to be permitted to rely on substituted compliance, the CFTC must find that the requirements of the entity's home jurisdiction are comparable to and as comprehensive as the CFTC's corresponding requirements. In December 2013, the CFTC issued comparability determinations to provide for substituted compliance for certain of the swap dealer business conduct standards—chief compliance officer, risk management, and swap data recordkeeping—for dealers located in Australia, Canada, the European Union (EU), Hong Kong, Japan, and Switzerland.[51]

The CFTC also has been working with the SEC and international regulators to harmonize their regulatory regimes. In July 2013, the CFTC and EU agreed upon a "Path Forward" to "implement their respective rules and regulations "in a manner that will address conflicts, inconsistencies, and uncertainty to the greatest extent possible consistent with international legal principles."[52] The CFTC and EU agreed on a territorial-based approach to jurisdiction over swaps activities, and for each jurisdiction to defer to the laws and regulations of the other when "it is justified by the quality of their respective regulation and enforcement regimes."[53]

The commission's decision to issue guidance as to the cross-border application of its rules rather than conduct a rulemaking under the Administrative Procedure Act (APA) has been challenged by several trade associations. In *SIFMA v. CFTC*, the trade associations claim that the Cross-Border Guidance is in reality a binding rule, and as such was not promulgated in accordance with the APA.[54] The plaintiffs also allege that, because the guidance is actually a rule, the commission impermissibly failed to consider the costs and benefits of its actions as required by CEA Section 15(a).

The plaintiffs also have challenged the commission's determination in 14 of its Dodd-Frank rulemakings to not consider the costs and benefits of the cross-border application of those rules within those rulemakings proceedings, but instead issue the cross-border interpretive guidance, without consideration of costs and benefits of the cross-border application of the affected

rules under section 15(a). They have requested that the court invalidate the guidance and the application of the 14 rules to cross-border activities. The plaintiffs also challenged various substantive interpretations within the guidance, claiming, for example, that the commission has misconstrued CEA Section 2(i) by "arbitrarily extending onerous swaps regulations to activities that lack a 'direct and significant' connection with, or effect on, U.S. commerce."[55]

The commission has countered that the guidance is not binding and therefore is not a rulemaking that is subject to the notice and comment provisions of the APA or a rule under CEA Section 15(a) for which the commission must consider the costs and benefits.[56] The commission argues that Section 2(i) is self-effectuating, and that pursuant to Section 2(i) the swaps provisions of the statute and the commission's swaps regulations apply to cross-border activities that meet the requisite "direct and significant" connection standard in the statute. In the commission's view, a rulemaking is not required to give the CFTC's regulations cross-border effect, and the commission could have enforced the application of Section 2(i) on a case-by-case basis. Hence, the commission argues, it could properly issue guidance informing market participants of the commission's view as to how Section 2(i) may apply under various circumstances, without having to conduct a rulemaking under the APA, and therefore without consideration of costs and benefits under Section 15(a).

The US District Court held a hearing on the merits of the case on July 30, 2014. No timetable for a decision has been established.

Proposed rules are outstanding in three major areas: capital requirements for nonbank swap dealers and MSPs, margin requirements for uncleared swaps for nonbank swap dealers and MSPs, and reproposed rules on speculative position limits.[57] It is anticipated that in the near future the commission will repropose rules relating to capital and margin requirements to reflect recently developed international standards.[58]

The commission initially issued a final rule to impose position limits, including rules to aggregate positions for entities under common ownership or control, in November 2011, but the rule was vacated by the US District Court just prior to it becoming effective.[59] In *ISDA v. CFTC*, the court ruled that the CFTC misinterpreted the Dodd-Frank Act to unambiguously require it to impose position limits without first making any findings that limits were necessary or appropriate. The court found that the statute was ambiguous with respect to the findings that were necessary prior to the imposition of position limits. It held that because the commission "fundamentally misunderstood and failed to recognize the ambiguities in the statute," its interpretation was not entitled to any deference.[60] Finding that the agency "failed to bring its expertise and experience to bear when interpreting the statute and offered no explanation for how its interpretation comported with the policy objectives of the Act," the court vacated the rule and remanded the rule to the agency to "fill in the gaps and resolve the ambiguities."[61] To date, this rule has been the only CFTC final rule that has been vacated by the courts.[62]

In November 2013, the commission reissued proposed regulations on position limits. The comment period initially closed in February 2014, but subsequently was extended until August 2014.[63]

CFTC Consideration of Costs and Benefits

Congress added the requirement for the CFTC to consider the costs and benefits of its regulations as part of the Commodity Futures Modernization Act of 2000 (CFMA).[64] The legislative history of the CFMA provides no further guidance regarding this requirement. Prior to Dodd-Frank neither the agency nor the public paid much attention to the provision.

In September 2010, shortly after the passage of the Dodd-Frank Act, "to ensure consistency across Commission rulemakings," the commission developed a "standard template" for its rulemaking teams to follow when considering costs and benefits under Section 15(a) in proposed rulemakings.[65] In developing the standard template and accompanying guidance, the commission relied upon and adopted many of the practices it had followed when considering costs and benefits in the previous rulemakings it had conducted since the passage of the CFMA.

The standard template provided language to be included in each discussion of costs and benefits explaining the commission's obligations under Section 15(a)

and identifying the five statutory considerations against which costs and benefits were to be evaluated. The language made clear the commission's interpretation that Section 15(a) did not require the commission to quantify the costs and benefits of a proposed or final rule, or to find that the benefits outweighed the costs: "By its terms, section 15(a) does not require the Commission to quantify the costs and benefits of a rule or to determine whether the benefits outweigh its costs; rather it requires that the Commission 'consider' the costs and benefits of its actions."

The template also indicated that the staff should explain briefly the requirements of the rule being proposed, and then set forth the commission's conclusions about the costs of the rule and its conclusions regarding the benefits. The template also included a two-sentence paragraph to invite public comment on the cost-benefit considerations.

The guidance accompanying the staff template stated that the commission's consideration of costs and benefits could be either quantitative or qualitative. In practice, these discussions typically were purely qualitative and could be quite brief. For example, in the proposed rule for the registration of SEFs, the consideration of costs and benefits under Section 15(a) filled approximately two columns of the 46-page notice in the *Federal Register*.[66] After devoting two paragraphs to an explanation of the requirements of Section 15(a), and one four-sentence paragraph to summarizing the proposed rule, the commission devoted five sentences in another paragraph to a qualitative discussion of the costs of the proposed rule, and another five sentences to qualitatively discussing the benefits. The commission invited then public comment using the two sentences set forth in the template.[67]

As the proposed rulemakings progressed, the CFTC's approach to considering costs and benefits under the standard template came under criticism, not just from commenters in particular rulemakings, but also from economists, members of Congress, and CFTC commissioners. Commissioner Jill Sommers stated, "The proposals we have issued thus far contain cursory, boilerplate cost-benefit analysis sections in which we have not attempted to quantify the costs because we are not required to do so under the Commodity Exchange Act. . . . I believe we should at least attempt to determine whether the costs outweigh the benefits."[68] "Without better cost-benefit analysis, these rules risk overturn in the DC Circuit," one witness testified to Congress. "And it is not enough to consider cost and benefits. They have to be analyzed, and conclusions have to be made."[69]

The commission's qualitative approach came under further scrutiny following President Obama's issuance of Executive Order 13563 in January 2011.[70] Executive Order 13563 directed federal agencies to conduct both qualitative and quantitative analyses of the costs and benefits of proposed and final regulations, and to propose or adopt regulations only "upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to quantify)."[71] The executive order required each agency "to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible," but also permitted agencies to consider and discuss qualitatively "values that are difficult or impossible to quantify, including equity, human dignity, fairness, and distributive impacts." It stated that each agency must identify and assess alternatives to direct regulation that could achieve the same objectives, "tailor its regulations to impose the least burdens on society," to the extent feasible specify performance objectives rather than prescriptive means of compliance, and select the regulatory approaches that "maximize net benefits."

The executive order did not apply to independent regulatory agencies like the CFTC and the SEC.[72] Nonetheless, the CFTC came under increasing pressure to conform its practices to those set forth in the executive order. In March 2011, Congressman Frank Lucas, chairman of the House Agriculture Committee, and Congressman Michael Conaway, chairman of the subcommittee with jurisdiction over the CFTC, asked the CFTC's Inspector General (IG) to review the CFTC's consideration of costs and benefits in four of the CFTC's proposed rules.[73] Asserting that the CFTC had taken a "vague and minimalist approach that is directly contrary to the President's Executive Order, and [that] fails to achieve the objectives of Section 15(a) of the CEA," Chairmen Lucas and Conaway asked the IG to determine whether "the CFTC is abiding by the requirements in section 15(a) to conduct cost-benefit analysis in a meaningful manner."

The IG's report found that the CFTC had adopted a "one size fits all" approach to its consideration of costs and benefits, and had not given sufficient regard to "addressing idiosyncratic cost and benefit issues that were shaping each rule, and were often addressed in the preamble."[74] The IG reported that "the Commission staff viewed section 15(a) compliance to constitute a legal issue more than an economic one." It stated that the commission viewed the cost-benefit requirement as "non-technical" and that the placement of the cost-benefit discussion after the Paperwork Reduction Act and Regulatory Flexibility Act analyses "might have given the impression that it was merely an administrative task associated with the rulemaking, rather than a substantive analysis of the rule." The IG was "troubled" by the absence of any quantitative data regarding industry compliance costs. The IG stated that although a review of the CFTC's interpretation of Section 15(a) was beyond the scope of its review, it suggested that "a more robust examination of costs and benefits should enhance the Agency's ability to defend its cost-benefit analyses." It recommended also that the CFTC's Office of Chief Economist be more involved in the analyses.

Shortly after the IG Released its report, ten members of the Senate Committee on Banking, Housing, and Urban Affairs asked the IG to review the adequacy of the CFTC's consideration of costs and benefits in four additional proposed rules.[75] The senators requested that the IG address the extent to which the agency used quantitative analysis in evaluating the costs and benefits of the proposed action, considered alternatives to the proposed rules, and examined the cost, benefits, and economic effects of alternatives. The letter also asked the IG to make recommendations as to how the agency could "improve the rigor and consistency of the agency's economic analysis."

In light of the executive order, and partially in response to the criticisms and concerns that had been raised regarding its consideration of costs and benefits for a number of the proposed Dodd-Frank rulemakings, in May 2011 the CFTC provided its rulemaking teams new guidance for the consideration of costs and benefits in final Dodd-Frank rulemakings (Final Rulemaking Guidance).[76] The Final Rulemaking Guidance was designed to make the CFTC's practices more consistent with the directives in the executive order, and significantly expanded the content and depth of the analyses to be conducted by the staff for the consideration of costs and benefits pursuant to Section 15(a). The Final Rulemaking Guidance stated that although Executive Order 13563 "does not govern the consideration of costs and benefits under section 15(a), rulemaking teams should consider costs and benefits in the Final Rulemakings utilizing the principles set forth in Executive Order 13563 in a manner that is reasonably feasible and appropriate, and consistent with the underlying statutory mandate."

The Final Rulemaking Guidance directed the rulemaking staff "to quantify costs and benefits to the extent when it is reasonably feasible and appropriate to do so." It directed the staff to summarize all of the public comments received as part of the agency's cost-benefit analysis, and in that discussion to respond to all meaningful comments regarding costs and benefits.[77] The guidance also provided for a greater role for the CFTC's chief economist, specifying that an economist from the Office of Chief Economist would be assigned to each rulemaking team to "provide input into the consideration of the quantification of costs and benefits" and review each draft cost-benefit discussion.

In June 2011 the CFTC IG issued its second report on the CFTC's consideration of costs and benefits.[78] The IG reiterated the concerns it had expressed in its previous report regarding the standard "one size fits all" methodology adopted for the consideration of costs and benefits in three of the four additional proposed rulemakings it reviewed. With respect to the fourth, which was the only one of the four rulemakings that had been issued after the IG's first report, the IG stated, "For the more recent cost-benefit analysis accompanying the proposed segregation/bankruptcy rule, we are pleased with the cost-benefit discussion." The IG observed "an evolution of the process from Fall 2010 to the present, with the cost-benefit analysis section of this proposed rule beginning as little more than a recitation of the template (as seen with the earlier proposed rules), and taking on greater detail in subsequent drafts." The IG repeated its suggestion that "a more robust examination of costs and benefits should only enhance the Agency's ability to defend its cost-benefit analyses." In this regard, the IG noted "with approval" the Final Rulemaking Guidance.

To bolster its consideration of costs and benefits, and to further its conformance with the principles

for cost-benefit analysis set forth in the executive orders, in May 2012 the commission entered into a Memorandum of Understanding (MOU) with the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget. The purpose of the MOU was for the CFTC to obtain "technical assistance ... during the implementation of [the Dodd-Frank Act], particularly with respect to the consideration of the costs and benefits of proposed and final action."[79] The MOU noted that "The CFTC staff's guidance for the consideration of costs and benefits in rulemakings is informed by OIRA's guidance for the conduct of cost-benefit analyses as well as the best practices of other federal agencies, to the extent permitted by law."

The CFTC's consideration of costs and benefits in the final rulemakings were more robust than those in the proposed rules. For example, although in the rulemaking on swap data reporting the commission's proposed consideration of cost and benefits included the language from the standard template and presented no quantification, in the final rulemaking the commission quantified a variety of costs, considered alternative approaches, sought to mitigate costs, and responded to significant comments.[80] The commission similarly upgraded its consideration of costs and benefits in the SEF final rule. Whereas in the proposed rule the discussion of costs and benefits constituted approximately two columns in the *Federal Register*, and contained no quantification, the discussion in the final rule included quantified estimates of a variety of costs and ran 24 pages.[81]

Judicial Review of SEC and CFTC Cost-Benefit Analyses

The concerns and criticisms regarding the adequacy of the CFTC's consideration of costs and benefits in the Dodd-Frank rulemakings intensified following the DC Circuit's opinion in July 2011 in *Business Roundtable v. SEC*, which overturned the SEC's "proxy access" rule on the grounds that the SEC had failed to adequately consider the economic consequences of the rule. The proxy access rule would have required companies to include in proxy materials the names of persons nominated by shareholders (only shareholders who held a specified minimum number of shares for a minimum period of time qualified under the rule) for election to the board of directors. In its review, the DC Circuit focused exclusively on the SEC's consideration of the economic consequences of the rule. Under the SEA, the SEC is required to consider in any rulemaking, "in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[82] Citing this "unique obligation," the court held that the SEC's "failure to 'apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation' makes promulgation of the rule arbitrary and capricious and not accordance with the law."[83] The court held that the SEC had "failed once again" to "adequately assess the economic effects of the new rule." The court stated:

> Here the Commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters.[84]

In a number of instances the court found that the SEC had failed to adequately quantify costs, and there was a lack of empirical data to support the SEC's conclusions in others. For example, the SEC had asserted that directors might choose not to oppose shareholder nominees, and therefore the costs of the proposal may be less than the plaintiffs had asserted. The court stated "the Commission has presented no evidence that such forbearance is ever seen in practice." It found the commission "did nothing to estimate and quantify the costs it expected companies to incur" in opposition to shareholder nominees, "nor did it claim estimating those costs was not possible."

The court also agreed with the petitioners that the SEC "relied upon insufficient empirical data" in concluding that the rule would improve board performance and increase shareholder value."[85] It noted that although the empirical evidence on this issue was "mixed," the commission relied "exclusively and heavily upon two relatively unpersuasive studies," and "has not sufficiently supported its conclusion."[86] In response to the SEC's statement that investment companies would incur certain increased costs and inefficiencies only in the event that shareholder nominees were elected, the court observed that "this rationale is tantamount to saying the saving grace of the rule is

that it will not entail costs if it is not used... to elect a director." It derided the SEC's point as "an utterly mindless reason for applying the rule to investment companies."[87]

Business Roundtable was the fourth case in recent years in which the DC Circuit overturned an SEC rule on the basis of inadequate economic analysis. In *American Equity Inv. Life Ins. Co. (American Equity) v. SEC*, the court invalidated the SEC's rule stating that fixed indexed annuities were not annuity contracts within the meaning of the Securities Act of 1933.[88] Although the court found that the SEC agency's interpretation of the statute was reasonable, it held that the agency's consideration of the effect of the rule on efficiency, competition, and capital formation was arbitrary and capricious. It stated that "the SEC purports to have analyzed the effect of the rule on competition, but does not disclose a reasoned basis for its conclusion that [the rule] would increase competition." Rather, the court found, the SEC simply asserted the rule would bring about clarity in an area in which there had been uncertainty. "The SEC cannot justify the adoption of a particular rule based solely on the assertion that the existence of a rule provides greater clarity to an area that remained unclear in the absence of any rule."[89] The court also found the competition analysis deficient for failing to assess "the baseline level of price transparency and information disclosure under state law" against which any increase or decrease in competition could be measured.[90]

In *Chamber of Commerce of the United States v. SEC (Chamber I)*, the DC Circuit invalidated the SEC's rule requiring investment companies engaging in certain transactions to have a board with no less than 75 percent independent directors and an independent chairman.[91] The court held that that the SEC failed to "adequately consider the costs imposed upon the funds by the two challenged conditions."[92] Specifically, the court found, the SEC had failed to adequately estimate the costs of the independent directors or chairman. In response to the SEC's assertion that it had no reliable basis for estimating the costs of electing independent directors, the court stated this "does not excuse the Commission from its statutory obligation to determine as best it can the economic implications of the rule it has proposed," and the Commission could at least have provided a range of potential costs.[93] Similarly, the court stated that although the commission may have had no reliable basis to estimate the aggregate cost of the independent director requirement to the mutual fund industry, it at least could have estimated the cost to individual funds. "[A]s we have just seen," the court wrote, "uncertainty may limit what the Commission can do, but it does not excuse the Commission from its statutory obligation to do what it can to apprise itself—and thence the public and the Congress—of the economic consequences of a proposed regulation before it decides whether to adopt the measure."[94]

Within one week after the court's decision in *Chamber I*, the SEC repromulgated the vacated rule, but this time it considered the costs of the independent directors and chairman. In repromulgating the rule, however, the commission did not reopen the rulemaking record or public comment period. In *Chamber of Commerce of the United States v. SEC (Chamber II),* the DC Circuit found that the failure to provide for public comment on the cost data violated the APA: "[B]ecause the Commission relied on extra-record material critical to its costs estimates without affording an opportunity for comment to the prejudice of the Chamber, we hold that the Commission violated the comment requirement of [APA] section 553(c)."[95] The court again vacated the rule.

The *Business Roundtable* decision prompted predictions of extensive litigation and led many to question whether the CFTC's cost-benefit analyses could survive the level of scrutiny the court had applied to the SEC's proxy access rule. "By some measures, the proxy rule was an unlikely choice to challenge on economic grounds," *The New York Times* reported. "The S.E.C. produced 60 pages on a cost-benefit analysis of the rule and spend 21,000 staff hours drafting it over two years.... That the proxy regulations still did not pass muster does not bode well for several other Dodd-Frank rules that received considerably less explication ...."[96]

"A major legal victory challenging a [an SEC] rule over inadequate cost-benefit analyses could create a wave of similar litigation targeting SEC and [CFTC] Dodd-Frank Rules," *Risk.net* reported. "More worryingly, perhaps," it observed, "lawyers suggest the cost-benefit analysis conducted by the SEC in the proxy access case was fairly sophisticated relative to

other regulators—the fact judges are not satisfied with the level of rigour applied by a much larger and better-resourced agency does not bode well for the CFTC, they say."[97] According to Reuters, "The ruling sent shivers down the spines of the SEC and [CFTC], and has them bracing for more court challenges as they strain to complete well over 100 rules called for in Dodd-Frank that was enacted last year."[98]

Administration officials contended that the real motivation underlying the challenges to the adequacy of the CFTC's cost-benefit analyses was to delay the implementation of financial reform. Then-Treasury Secretary Tim Geithner charged, "The forces moving against [financial] reform are trying a range of different strategies, including blocking appointments of new leadership to oversight positions, cutting funding, policy riders on appropriations bills, new legislation to repeal the entire law or just critical pieces of it, efforts to use cost-benefit analysis as roadblocks to reform, and other efforts to slow the pace of implementation of regulation in the hopes of watering it down."[99]

CFTC Commissioner Bart Chilton stated, "[W]e have seen an obnoxious bastardization of the conduct and use of CBAs [cost-benefit analyses] in regulatory rulemaking.... CBAs are being used, as I have said before, as a Sword of Damocles over regulatory agencies. We are virtually paralyzed by intimidation—or, indeed, the reality—of lawsuits brought (haphazardly, in my assessment) on the foundations of allegedly poor CBAs."[100]

Several legal commenters asserted that the standard of review of the SEC's proxy access rule used by the DC Circuit in *Business Roundtable* was much higher than the traditional deferential standard of review under the APA. "The level of review invoked by the DC Circuit in *Business Roundtable* and its earlier decisions is dramatically inconsistent with the standard enacted by Congress," one legal analysis concluded. "[T]he Review Standard [that is, the requirement that the SEC consider the effect of a rule upon efficiency, competition, and capital formation] does not explicitly require the SEC to specify the costs of any proposed rule, to engage in rigorous analysis, or even to engage in cost-benefit analysis.... It seems unlikely that the Review Standard was truly designed to establish more than a thoughtful analysis of the proposed rule's potential effects."[101] Better Markets asserted that the DC Circuit in *Business Roundtable* "repeatedly substituted its own judgment for that of the agency."[102]

Eugene Scalia, the lead attorney in *Business Roundtable*, *Chamber I and II*, and *American Equity*, took issue with the arguments regarding the standard of review and judicial bias against financial reform. "The left is trying to stigmatize appellate judges, but the real culprits are badly written regulations," Scalia wrote. "The truth is that the D.C. Circuit is an admirably nonideological court that applies principles of administrative law evenhandedly.... The SEC (and lately, the CFTC) often does a poor job with the hard work of the rule-making process."[103]

Largely as a result of the *Business Roundtable* decision, the SEC also issued new guidance for the SEC staff to follow in SEC rulemakings.[104] The major elements of the SEC's guidance directed the staff to[105]

(1) clearly identify the justification for the proposed rule;
(2) define the baseline against which to measure the proposed rule's economic impact;
(3) identify and discuss reasonable alternatives; and
(4) analyze the economic consequences of the proposed rule and the principal regulatory alternatives, including quantification of expected benefits and costs to the extent feasible, a discussion of any uncertainties underlying the estimates and, for elements that are not quantified, a discussion of why they cannot be quantified.

In fact, the apocalyptic predictions that financial reform would stall in the DC Circuit—due either to inadequate cost-benefit analyses by the CFTC and SEC, or as a result of a higher standard of review adopted by the court—have not been realized. In the two most recent cases in which the DC Circuit has reviewed CFTC cost-benefit considerations and the SEC's consideration of economic costs, the court has upheld the agency actions.

The first of these cases, *ICI v. CFTC*, involved a challenge to the CFTC's rule rescinding the exclusion the CFTC had previously granted from status as a commodity pool operator (CPO) for registered investment companies (for example, mutual funds) regulated by

the SEC.[106] The appellants had challenged both the CFTC's rationale for the rule and its consideration of costs and benefits. With respect to the agency's decision to revoke the exemption, the DC Circuit applied the well-established deferential standard under the APA for the agency's change. "[T]he APA imposes no heightened obligation on agencies to explain 'why the original reasons for adopting the displaced rule or policy are no longer dispositive,'" the court stated. The agency need only provide a "reasoned explanation" for its decision, and the court need only be able to "'reasonably … discern[]' the agency's path." Citing the "congressional shift evidenced in the Dodd-Frank Act," the court found the CFTC's rule "clears this low bar."[107]

The court applied similarly deferential standards in its review of the agency's consideration of costs and benefits: "'[O]ur role is to determine whether the [agency] decision was based on a consideration of the relevant factors, and whether there has been a clear error of judgment.'"[108] With respect to the plaintiff's arguments that the CFTC had failed to consider the adequacy of existing SEC regulations of investment companies, as required by the *Business Roundtable* and *American Equity* precedents, the court stated it was "unconvinced." "[U]nlike the SEC in the other two cases," the court found, the "'CFTC did consider whether RICs [registered investment companies] were otherwise regulated and concluded that CFTC regulation was necessary despite the existing SEC regime.'"[109]

The court also rejected the appellants' claim that the CFTC failed to quantify the benefits of the rule, in particular the benefit of data collection in preventing future financial crises: "[T]he law does not require agencies to measure the immeasurable. CFTC's discussion of unquantifiable benefits fulfills its statutory obligation to consider and evaluate potential costs and benefits." The court's opinion is broader, however, than simply holding that the CFTC is not required to quantify costs and benefits when it is infeasible to do so. Rather, the court's opinion goes further and states without qualification that CEA Section 15(a) does not require "rigorous, quantitative economic analysis." "Where Congress has required 'rigorous, quantitative economic analysis,'" the court wrote, "it has made that requirement clear in the agency's statute, but it has imposed no such requirement here."[110] The court therefore held that the agency's consideration of costs and benefits was not arbitrary or capricious.[111]

Ten months later, in *National Association of Manufacturers (NAM) v. SEC*, the DC Circuit followed similar logic to reject a challenge to the SEC's consideration of costs and benefits in promulgating a rule under the Dodd-Frank Act to require companies to make certain disclosures regarding their use of "conflict minerals," which were defined as minerals originating in the Congo or an adjoining country.[112] "We do not see any problems with the Commission's cost-side analysis," the court stated. "The Commission exhaustively analyzed the final rule's costs." Although the court found that certain of the mandated disclosures violated the First Amendment, the court rejected the other challenges. With respect to appellants' claims that the SEC failed to adequately consider whether the rule would achieve its intended purpose, the court found "it difficult to see what the Commission could do better." It noted that due to an absence of data about the rule's effects, the agency could not "readily quantify" the benefits of the rule. "This determination was reasonable," the court stated. Citing the recent decision in *ICI*, the court held "An agency is not required 'to measure the immeasurable,' and need not conduct a 'rigorous, quantitative economic analysis' unless the statute explicitly directs it to do so."[113]

Conclusion

In a string of decisions overturning SEC rules that stretched into the midst of the Dodd-Frank rulemaking process, the DC Circuit had signaled that when considering the economic consequences of a regulation an agency should:

- quantify costs or explain why it is not feasible to do so (*Business Roundtable*);
- rely upon empirical data to support its conclusions (*Business Roundtable*);
- provide estimates or ranges when more precise data is not available (*Chamber I*);
- develop an appropriate "baseline" against which the costs and benefits of the rule may be measured (*American Equity*); and
- provide notice and comment for significant cost data relied upon by the agency (*Chamber II*).

Concern over the survivability of its Dodd-Frank rules under these standards was a significant factor

underlying the CFTC's shift toward more quantification, fuller consideration of alternatives, and increased responsiveness to commenters in its consideration of costs and benefits during the Dodd-Frank rulemaking process. For largely the same reasons, the SEC also strengthened its economic and cost-benefit analyses during the Dodd-Frank rulemaking process. The presidential executive orders on cost-benefit analysis, congressional pressure, internal inspector general reports, and public comments also were significant factors leading to these improvements.

The DC Circuit's decisions in *Business Roundtable*, *American Equity*, and *Chamber I and II*, are therefore likely to have a lasting effect upon the way the CFTC and SEC consider costs and benefits in their rulemakings. The DC Circuit's more recent decisions in *ICI* and *NAM* indicate, however, that there are limits as to what agencies may be required to consider in evaluating costs and benefits or conducting economic analyses under their existing statutes. Neither agency is required to conduct a "rigorous, economic analysis," or "measure the immeasurable." *ICI* and *NAM* indicate that the agencies' current practices in this regard are sufficient—to quantify when reasonably feasible to do so, and, if it is not feasible, to explain why not. The agencies are not required to quantify costs when it is not reasonably feasible to do so – to "measure the immeasurable." *ICI* and *NAM* also indicate that the agency consideration of costs and benefits should be afforded the traditional degree of deference upon judicial review. Contrary to many of the predictions following the *Business Roundtable* decision, under these cases the chances that the DC Circuit will be the graveyard for Dodd-Frank regulations have greatly diminished.

Notes

1. Pub. L. No. 111-203, 124 Stat. 1376 (2010) (Dodd-Frank Act).
2. The Securities and Exchange Commission (SEC) has issued proposals for nearly all of the required rulemakings and has begun to issue final regulations. The SEC's summary of its proposed and final rulemakings for security-based swaps, and its "road map" for future rulemakings is available at *http://www.sec.gov/spotlight/dodd-frank/derivatives.shtml*, last accessed Aug. 24, 2014. In this article, which is focused primarily on the CFTC's implementation of the Dodd-Frank Act, references to the parallel SEC authority over security-based swaps are sometimes omitted.
3. *International Swaps and Derivatives Ass'n (ISDA) v. CFTC*, 887 F. Supp. 2d 259 (D.D.C. 2012).
4. Adjudicatory, investigatory, and emergency orders are exempt from this requirement. 7 U.S.C. § 19(a).
5. 7 U.S.C. § 19(a)(2).
6. *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011). The SEC's rule required companies to include shareholder nominees for election to the board of directors in proxy materials.
7. Section 23(a) of the Securities Exchange Act (SEA) requires the commission in any rulemaking to consider the effect of the rule upon competition, and prohibits the commission from adopting any rule "which would impose a burden on competition not necessary or appropriate" to advance the purposes of securities laws. 15 U.S.C. § 78w(a)(2). The Securities Exchange Act also requires the SEC to consider in its rulemakings "in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." 15 U.S.C. § 78c(f). The SEC refers to this as "economic analysis." For many years the SEC voluntarily conducted a separate cost-benefit analysis; the SEC now conducts an integrated cost-benefit and economic analysis. S*ee The SEC's Aversion to Cost Benefit Analysis*, Hearing Before the Subcomm. on TARP, Financial Services, and Bailouts of Public and Private Programs of the House Comm. on Oversight and Gov't Reform, 112th Cong. (2012) *(SEC Oversight Hearing*) (testimony of SEC Chair Mary Schapiro).
8. *ICI v. CFTC*, 720 F.3d 370 (D.C. Cir. 2013); *NAM v. SEC*, 748 F.3d 359 (D.C. Cir. 2014).
9. *See also* Dan M. Berkovitz, "The CFTC's Implementation of Financial Market Reform: Progress and Legal Challenges," 34 *Futures & Derivatives Law Report* (Vol. 4, April 2014).
10. The Financial Crisis Inquiry Report, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States,* at pp.xxv (PublicAffairs, Jan. 2011).
11. The legislation mandated that the CFTC and SEC issue joint regulations to further define the terms "swap," "security-based swap," "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," "eligible contract participant," and "security-based swap agreement." Dodd-Frank Act, § 712(d). With respect to all other regulations the CFTC and SEC were directed to "consult and coordinate to the extent possible" with each other and the prudential regulators. Dodd-Frank Act, § 712(a). The Act further directed the CFTC, SEC, and prudential regulators to consult and coordinate with foreign regulatory authorities to establish "consistent international standards" for the regulation of the swaps market. Dodd-Frank Act, § 752. The Act generally required the agencies to complete their rulemakings within 360 days of enactment. Dodd-Frank Act, § 712(e).
12. 7 U.S.C. § 6s(a).
13. 7 U.S.C. § 6s(h)(1).
14. 7 U.S.C. §§ 6s(f)-(j).
15. 7 U.S.C. §§ 6s(h)(2), (4), and (5).
16. 7 U.S.C. § 6s(e).
17. 7 U.S.C. § 2(h)(2)(A). The Act also specified the factors for the CFTC to consider in making a mandatory clearing determination. 7 U.S.C. § 2(h)(2)(D).

18. 7 U.S.C. § 2(h)(1)(A).
19. 7 U.S.C. § 2(h)(7)(A). The commission was provided discretion whether to exclude small banks, savings associations, farm credit system institutions, and credit unions, including such institutions with less than $10 billion in assets, from the clearing requirement. 7 U.S.C. § 2(h)(7)(C)(ii). Certain financing affiliates were also excluded from the clearing requirement. 7 U.S.C. § 2(h)(7)(D).
20. 7 U.S.C. § 2(h)(8).
21. 7 U.S.C. § 2(a)(13)(G).
22. 7 U.S.C. §§ 2(a)(13)(A), (C).
23. 7 U.S.C. § 24a (registration and core principles for SDRs); § 7b-3 (registration and core principles for SEFs).
24. 7 U.S.C. § 7a-1 (registration and core principles for DCOs); § 7 (registration and core principles for DCMs).
25. 7 U.S.C. § 9(c). This new authority is in addition to the preexisting prohibition in the CEA against manipulation and attempted manipulation. 7 U.S.C. § 13(a)(2). Unlike the preexisting CEA standard for manipulation, which has been interpreted to require the CFTC to prove that a person specifically intended to and did create an artificial price, under the new fraud-based standard the CFTC need prove only that the person intentionally or recklessly employed a manipulative or deceptive device. *See* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 *Fed. Reg.* 41,398 (July 14, 2011).
26. 7 U.S.C. § 6c(5).
27. 7 U.S.C. § 6c(4). The provision is named after one of the costars in the fictional comedy movie "Trading Places." In the movie, the character played by Eddie Murphy, together with the character played by Dan Ackroyd, steals a nonpublic government report on the orange juice crop and uses that information to profitably trade futures contracts for frozen concentrated orange juice. Prior to the "Eddie Murphy" provision in the Dodd-Frank Act, the CEA did not prohibit the use of such nonpublic governmental information in the trading of futures contracts.
28. 7 U.S.C. § 26.
29. Dodd-Frank Act, § 722(d); 7 U.S.C. § 2(i).
30. Dodd-Frank Act, § 737.
31. 7 U.S.C. § 6a(a)(2).
32. The commission must, "to the maximum extent practicable," set these limits to achieve the following objectives: diminish, prevent, or eliminate excessive speculation; deter and prevent market manipulation, squeezes, and corners; ensure sufficient market liquidity for bona fide hedgers, and ensure that the price discovery function of the underlying market is not disrupted. 7 U.S.C. § 6a(a)(3).
33. 7 U.S.C. § 6a(a)(5).
34. 7 U.S.C. § 6a(c).
35. Remarks of Chairman Gary Gensler at a D.C. Bar Event—"A Transformed Marketplace," December 11, 2013.
36. Second Amendment to July 14, 2011, Order for Swap Regulation, 77 *Fed. Reg.* 41,260 (July 13, 2012); Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 *Fed. Reg.* 48,208 (Aug. 13, 2012).
37. Business Conduct and Documentation Requirements for Swap Dealers and Major Swap Participants; Extension of Compliance Date, 78 *Fed. Reg.* 17 (Jan. 2, 2013) (extension of compliance date for certain documentation standards).
38. Nondealers and non-MSPs began to report swaps in April, 2013. CFTC Staff, "Q & A—On Start of Swap Data Reporting" (Oct. 9, 2012); available at *http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/startreporting_qa_final.pdf*, last accessed Aug. 24, 2014. The CFTC granted several extensions from the commencement of reporting for several of the swap data reporting requirements.
39. *http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer,* last accessed Aug. 24, 2014; *http://www.cftc.gov/LawRegulation/DoddFrankAct/registermajorswappart,* last accessed Aug. 24, 2014.
40. Clearing Requirement Determination Under Section 2(h) of the CEA, 77 *Fed. Reg.* 74,284 (Dec. 13, 2012).
41. CFTC Announces that Mandatory Clearing Begins Today, Release PR6529-13 (March 11, 2013); 17 C.F.R. § 50.25.
42. *See http://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=SwapExecutionFacilities,* last accessed Aug. 24, 2014. The CFTC is reviewing the applications of these SEFs to determine whether to grant permanent registration.
43. *See http://sirt.cftc.gov/sirt/sirt.aspx?Topic=SwapsMadeAvailableToTradeDetermination*, last accessed Aug. 24, 2014.
44. *See, e.g.*, The Commodity Futures Trading Commission's Division of Market Oversight Announces Trade Execution Mandate for Certain Credit Default Swaps and Additional Interest Rate Swaps, Release: PR6841-14, January 28, 2014.
45. *See http://sirt.cftc.gov/sirt/sirt.aspx?Topic=DataRepositories,* last accessed Aug. 24, 2014.
46. *http://www.cftc.gov/MarketReports/SwapsReports/L1GrossExpCS,* last accessed Aug. 24, 2014.
47. Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 *Fed. Reg.* 45,292 (July 26, 2013).
48. For this purpose, the CFTC categorized the various regulatory requirements applicable to swap dealers and MSPs as either "entity-level," meaning that the requirement applied to the entity as whole and to all transactions entered into by the entity, regardless of the nature or type of counterparty, or "transaction-level," meaning that the determination of whether the requirement would apply would be made on a transaction-by-transaction basis, depending on the type of counterparty. The entity-level requirements include requirements relating to chief compliance officer (CCO), risk management, capital, swap data reporting, and swap data recordkeeping. Other requirements, such as clearing, trade

execution, real-time reporting, swap dealer and MSP business conduct standards relating to disclosure and documentation, are categorized as transaction-level requirements. Cross-Border Guidance, 78 *Fed. Reg.* at 45,337–45,340; 45,346–45,361; 45,364–45,370.

49. Cross-Border Guidance, 78 *Fed. Reg.* at 45,361–45,364.
50. Cross-Border Guidance, 78 *Fed. Reg.* at 45,340–45,345.
51. The CFTC also provided substituted compliance for the portfolio compression and reconciliation, trade confirmation, swap trading relationship documentation, and daily trading records requirements for swap dealers located in the EU, and for the swap trading relationship documentation and daily trading records requirements for swap dealers in Japan. Each of the CFTC's Comparability Determinations can be found at *http://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm,* last accessed Aug. 24, 2014.
52. CFTC, Cross-Border Regulation of Swaps/Derivatives, Discussions between the Commodity Futures Trading Commission and the European Union—A Path Forward (Path Forward) (July 11, 2013); available at *http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/jointdiscussionscftc_europeanu.pd,* last accessed Aug. 24, 2014*f.*
53. The CFTC will look to whether the regulations of the other jurisdiction are "comparable to, and as comprehensive" as those of the CFTC. The EU has adopted the principle of "equivalence," which is "based on a broad outcomes-based assessment of the regulatory framework" of the other jurisdiction. Path Forward, at 2. The Path Forward document identified several areas in which the EU and US viewed their rules as "essentially identical," such as risk mitigation rules for bilateral uncleared swaps, the process for determining whether swaps should be required to be cleared, and the regulation of interaffiliate trades.
54. *Securities Industry and Financial Markets Association, International Swaps and Derivatives Association, and Institute of International Bankers (SIFMA) v. CFTC*, Civil Action No. 13-CV-1916 (D.D.C. filed Dec. 4, 2013), Pl's Mot. for S.J., at 23 (filed Dec. 27, 2013).
55. *SIFMA v. CFTC*, Pl's Mot. for S.J., at 30 (initial caps omitted).
56. *SIFMA v. CFTC,* Def's Cross-Mot. for S.J. (filed Mar. 16, 2014).
57. Capital Requirements of Swap Dealers and Major Swap Participants (Proposed Rule), 76 *Fed. Reg.* 27,802 (May 12, 2011); Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (proposed rule), 76 *Fed. Reg.* 23,732 (May 12, 2011); Position Limits for Derivatives (proposed rule), 78 *Fed. Reg.* 75,680 (Dec. 12, 2013); Aggregation of Positions (proposed rule), 78 *Fed. Reg.* 68,946 (Nov. 15, 2013).
58. *See* Basel Committee on Banking Supervision, Board of the International Organization of Securities Commissions, Margin requirements for non–centrally cleared derivatives (Sept. 2013).
59. Position Limits for Futures and Swaps, 76 *Fed. Reg.* 71,626 (Nov. 18, 2011).
60. *ISDA v. CFTC*, *supra* n.3, 887 F. Supp. 2d at 284. The court also rejected the plaintiff's interpretation that the statute unambiguously requires the CFTC to find that position limits are necessary and appropriate prior to imposing position limits.
61. *ISDA v. CFTC*, *supra* n.3, 887 F. Supp. 2d at 282, 284.
62. Two other lawsuits have been decided and two more are pending. In *ICI v. CFTC*, which is discussed later, the D.C. Circuit upheld the CFTC's rule. A challenge to the CFTC's rulemaking establishing standards for calculating margin requirements for cleared swaps was dismissed for lack of standing. *Bloomberg v. CFTC*, 949 F. Supp. 2d 91 (D.D.C. 2013). As discussed, the challenge to the CFTC's cross-border guidance in *SIFMA v. CFTC* is pending. In another pending case, the plaintiffs have challenged the commission's approval of a rule of the Chicago Mercantile Exchange (CME) that requires the reporting of cleared swaps to the CME's swap data repository, and the self-certification of a similar rule by ICE Clear Credit, another DCO. In ruling upon the CFTC's motion to dismiss, the court held that the self-certification of the ICE rule was not a reviewable final agency action, but denied the motion with respect to two of the plaintiff's claims regarding the CFTC's approval of the CME rule. *DTCC Data Repository (U.S.) LLC v CFTC*, 2014 U.S. Dist. LEXIS 30195 (D.D.C. March 10, 2014).
63. Position Limits for Derivatives and Aggregation of Positions (extension of comment periods), 79 *Fed. Reg.* 37,973 (July 3, 2014).
64. H.R. 5660, 106th Cong., § 119 (2000) (enacted into law by P.L. 106-554, § 1(a)(5), 114 Stat. 2763 (Dec. 21, 2000).
65. Memorandum from Dan M. Berkovitz, General Counsel, and Jim Moser, Acting Chief Economist, to Rulemaking Teams, Re: Guidance on and Template for Presenting Cost–Benefit Analyses for Commission Rulemakings, Sept. 29, 2010 (2010 Cost–Benefit Guidance).
66. Core Principles and Other Requirements for Swap Execution Facilities (proposed rule) (SEF Proposed Rule), 76 *Fed. Reg.* 1,214; 1,236–7 (Jan. 7, 2011).
67. SEF Proposed Rule, 76 *Fed. Reg.*, at 1,237. The brevity of the cost–benefit discussion in the SEF Proposed Rule was not unique. *See, e.g.*, Real-Time Public Reporting of Swap Transaction Data (proposed rule), 75 *Fed. Reg.* 76,140, 76,167–76,168 (Dec. 7, 2010); Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties (proposed rule), 75 *Fed. Reg.* 80,638, 80,656–80,657 (Dec. 22, 2010).
68. Comm. Jill Sommers, Remarks before OpenLink's 2011 Worldwide User Conference, April 6, 2011.
69. *Implementing Dodd-Frank: A Review of the CFTC's Rulemaking Process*, Hearing Before the H. Comm. on Agriculture Subcomm. on General Farm Commodities and Risk Management, 112th Cong. 38 (2011) (statement of Hal Scott, Comm. on Capital Markets Reg.; Nomura Prof. and Dir., Prog. on Int'l Financial Systems, Harvard Law School).
70. *See, e.g.*, Comm. Scott O'Malia, Opening Statement, Thirteenth Series of Proposed Rulemakings Under the Dodd-Frank Act, April 6, 2011 ("[W]e did not conduct a robust cost

benefit analysis, which is inconsistent with President Obama's Executive Order.").

71. *Improving Regulation and Regulatory Review*, Exec. Order No. 13563, 76 *Fed. Reg.* 3821 (January 18, 2011). Executive Order 13563 was designed to "affirm and supplement Executive Order 12866." Mem. for the Heads of Exec. Departments and Agencies, and of Independent. Regulatory Agencies, "Executive Order 13563, 'Improving Regulation and Regulatory Review,'' from Cass Sunstein, Administrator, Office of Information and Regulatory Affairs (Feb. 2, 2011). Executive Order 12866 was issued by President Clinton in 1993 and established many of the principles regarding the consideration of costs and benefits that were subsequently included in Executive Order 13563. *Regulatory Planning and Review*, Exec. Order No. 12866, 58 *Fed. Reg.* 51,735 (Oct. 4, 1993).

72. In July 2011, six months after the issuance of Executive Order 13563, President Obama issued Executive Order 13579 that applied Executive Order 13563 to independent regulatory agencies "to the extent permitted by law." *Regulation and Independent Regulatory Agencies*, Exec. Order No. 13579, 76 *Fed. Reg.* 41,587 (July 14, 2011).

73. Letter from Frank D. Lucas, Chairman, House Comm. on Agriculture, and K. Michael Conaway, Chairman, Subcomm. on General Farm Commodities and Risk Management to Roy Lavik, Inspector General, CFTC, March 11, 2011.

74. CFTC Office of the Inspector General, An Investigation Regarding Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act (April 15, 2011). The IG found that even when the technical staff had considered specific costs and benefits in developing a rule, those specific costs and benefits were not discussed in the cost-benefit analyses under Section 15(a).

75. Letter from Senators Richard Shelby, Mike Crapo, Roger Wicker, Pat Toomey, Jerry Moran, Jim DeMint, Mike Johanns, Mark Kirk, Bob Corker, and David Vitter to Roy Lavik, Inspector General, CFTC, May 4, 2011. The letter also was addressed to the inspectors general of the SEC, Federal Reserve Board, and Federal Deposit Insurance Corporation and identified specific proposed rules issued by those agencies for those respective inspectors general to review. Subsequently, these senators introduced legislation that would require the CFTC and other federal agencies to conduct a 12-part economic analysis of each proposed and final rule and would prevent the agency from finalizing any rule if it determined, as part of the economic analysis, that the quantified costs are greater than the quantified benefits. Many of these requirements were based on the principles in the executive order. S.1615, 112th Cong. (2011); *see also* S.1606, 112th Cong., 1st Sess. (2011) (legislation introduced by Sens. Portman and Pryor).

76. Memorandum from Dan M. Berkovitz, General Counsel, and Andrei Kirilenko, Chief Economist, to Rulemaking Teams, Re: Staff Guidance on Cost-Benefit Considerations for Final Rulemakings under the Dodd-Frank Act, May 13, 2011.

77. The Final Rulemaking Guidance noted that "When comments raise concerns about rulemaking provisions that merely replicate the statutory provisions the Commission is required to promulgate without the exercise of discretion, then cost-benefit considerations may not be a factor in the promulgation of the rule."

78. CFTC Office of the Inspector General, A Review of Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act (June 13, 2011).

79. Memorandum of Understanding, available at *http://www.whitehouse.gov/sites/default/files/omb/inforeg/regpol/oira_cftc_mou_2012.pdf,* last accessed Aug. 24, 2014. OIRA is the lead office within the Executive Office of the President for the oversight of and review of cost-benefit analyses in executive agency rulemakings.

80. Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, 77 *Fed. Reg.* 35,200, 35,217–35,225 (June 12, 2012).

81. Core Principles and Other Requirements for Swap Execution Facilities, 78 *Fed. Reg.* 33,476, 33,556–33,580 (June 4, 2013).

82. 15 U.S.C. § 78c(f). *See*, *supra* n.7.

83. *Business Roundtable*, *supra* n.6, 647 F.3d at 1148.

84. *Business Roundtable*, *supra* n.6, 647 F.3d at 1149.

85. *Business Roundtable*, *supra* n.6, 647 F.3d at 1150.

86. *Business Roundtable*, *supra* n.6, 647 F.3d at 1151.

87. *Business Roundtable*, *supra* n.6, 647 F.3d at 1156. The court also found that the SEC had failed to explain why applying the rule to investment companies would yield net benefits in light of the costs, and whether the regulatory requirements of the Investment Company Act reduced the need for such additional regulation.

88. *American Equity v. SEC*, 613 F.3d 166 (D.C. Cir. 2010).

89. *American Equity*, 613 F.3d at 177.

90. *American Equity*, 613 F.3d at 178. The court also found the SEC's efficiency analysis deficient for failure to consider the efficiency of the existing state law regime.

91. *Chamber of Commerce of the United States v. SEC*, 412 F.3d 133 (D.C. Cir. 2005).

92. *Chamber I*, 412 F.3d at 144.

93. *Chamber I*, 412 F.3d at 143.

94. *Chamber I*, 412 F.3d at 144. The court also found that the SEC violated the APA by failing to consider an alternative approach based on increased disclosure of board composition that were suggested by two dissenting commissioners.

95. *Chamber of Commerce of the United States v. SEC*, 443 F.3d 890, 908 (D.C. Cir. 2006). The SEC had expedited its reconsideration of the rule so it could vote on its reissuance prior to the expiration of the chairman's term. The court held that "the Commission's preference to proceed with the same five Commission members who were familiar with the [original rulemaking] is not the type of exigent circumstance that comes within the narrow 'good cause' exception" to the notice-and-comment requirement. *Id.*

96. Ben Protess, "Court Ruling Offers Path to Challenge Dodd-Frank," *N.Y. Times*, August 17, 2011.

97. Peter Madigan, "CFTC and SEC facing legal anxiety over cost-benefit analyses," *Risk.net*, Oct. 3, 2011; available at *http://www.risk.net/risk-magazine/feature/2111501/cftc-sec-facing-legal-anxiety-cost-benefit-analyses*.

98. Sarah N. Lynch and Christopher Doering, Analysis: *Bruised regulators brace for Dodd-Frank court fights*, Reuters, August 4, 2011. *See also* Letter from R. Glenn Hubbard, John L. Thornton, Hal S. Scott, Committee on Capital Markets Regulation, to Timothy Johnson, Chairman, and Richard Shelby, Ranking Member, Senate Comm. on Banking Housing and Urban Affairs, and Spencer Bachus, Chairman, and Barney Frank, Ranking Member, House Financial Services Comm., March 7, 2012 ("Particularly in light of the ruling this past July [in *Business Roundtable*], and a current lawsuit seeking to strike down the [CFTC's] recently promulgated position limits rule, we believe that many of the rules under Dodd-Frank could be subject to successful challenge in the courts due to inadequate cost-benefit analyses.").

99. Remarks by Secretary Tim Geithner "The Macroprudential Toolkit: Measurement and Analysis" Conference, Dec. 1, 2011.

100. "The Thing Is," Speech of Commissioner Bart Chilton before Americans for Financial Reform, Washington, DC, May 9, 2012.

101. James D. Cox & Benjamin Baucom, "The Emperor Has No Clothes: Confronting the D.C. Circuit's Usurpation of SEC Rulemaking Authority," 90 *Tex. L. Rev.* 1811, 1813, 1824 (2012). *See also* Bruce Kraus and Conner Raso, "Rational Boundaries for SEC Cost-Benefit Analyses," 30 *Yale J. on Reg.* 289, 316 (Summer 2013) ("The court appears to have applied a new burden of proof—the opposite of deference.").

102. Better Markets, *Setting the Record Straight on Cost-Benefit Analysis and Financial Reform at the SEC*, at p.50 (July 30, 2012). Better Markets, which describes itself as "a Wall Street watchdog," also charged, "Wall Street is attempting to kill or weaken the implementation of financial reform through the application of cost-benefit analysis, a methodology that is incompatible with effective financial regulation." *Id.* at 7.

103. Eugene Scalia, "Why Dodd-Frank Rules Keep Losing in Court," *Wall St. J.*, Oct. 3, 2012.

104. Memorandum from RSFI and OGC to Staff of the Rulewriting Divisions and Offices, Re: Current Guidance on Economic Analysis in SEC Rulemakings, March 16, 2012; available at *http://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf,* last accessed Aug. 24, 2014.

105. The SEC's Guidance also responded to a number of issues raised in a report by the SEC's Inspector General. Office of Inspector General, Follow-up Review of Cost-Benefit Analyses in Selected SEC Dodd-Frank Act Rulemakings (Jan. 27, 2012). *But also see SEC Oversight Hearing* (testimony of SEC Chair Mary Schapiro responding to the IG report and describing improvements in the SEC's cost-benefit analyses).

106. *ICI v. CFTC*, 720 F.3d 370 (D.C. Cir. 2013).

107. *ICI*, 720 F.3d at 373. The court also rejected each of the plaintiff's challenges to specific provisions in the rule under the traditional "arbitrary and capricious" standard under the APA. For example, with respect to the specific *de minimis* level of trading established by the commission below which registration would not be required, the court stated, "When a line has to be drawn, [the CFTC] is authorized to make a rational legislative-type judgment. If the figure selected by the agency reflects its informed discretion, and is neither patently unreasonable nor a dictate of unbridled whim, then the agency's decision adequately satisfies the standard of review." *Id.* at 380-381.

108. *ICI*, 720 F.3d at 377.

109. *Id.* at 378, citing *ICI v. CFTC*, 891 F. Supp. 2d 162, 219 (D.D.C. 2013). Judge Sentelle, who wrote the court's opinion in *ICI*, also wrote the court's decision in *American Equity*. Judge Sentelle's opinion in *American Equity* can also be viewed as applying the traditional standard of review. *See, e.g.*, Cox and Baucom, *supra* n.101.

110. *ICI*, 720 F.3d at 378. The court also dismissed appellants' argument that the CFTC should have gathered additional market data to support its analysis. *Id.* at 380.

111. Appellants also claimed that the CFTC's discussion of costs and benefits in the proposed rule "did not set out the basis for the Final Rule's analysis . . . ." In the proposed rule, the CFTC's consideration of costs and benefits followed the standard template. *See* Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 *Fed. Reg.* 7976, 7988–7989 (Feb. 11, 2011). The court rejected the notice challenge. "The proposed rule included a separate section entitled 'Cost-Benefit Analysis' that gave adequate notice of CFTC's approach to the cost-benefit analysis by setting forth the factors that CFTC would consider and summarizing expected costs and benefits." *Id.*

112. *NAM*, 748 F.3d 359 (D.C. Cir. 2014). Section 1502 of the Dodd-Frank Act required the SEC to issue regulations requiring firms using "conflict minerals" to investigate and disclose the origin of those minerals. 15 U.S.C. §§ 78m(p), 78m note.

113. *NAM*, 748 F.3d at 369. The court also held that the commission need not "second-guess" Congress with respect to determining that a disclosure regime would produce the intended benefits of the statute. The court did, however, find that certain of the mandated disclosures would violate the First Amendment. *Id.* at 370, 373.

Posted from Banking & Financial Services, September 2014, with permission from Aspen Publishers,
a WoltersKluwer Company, New York, NY1-800-638-8437, www.aspenpublishers.com.
For more information on the use of this content, contact Wright's Media at 877-652-5295.

113409