

SEC Rulemaking and Implementation Under the Dodd-Frank Act

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The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act) provides sweeping financial reform and increased regulatory oversight of the United States' financial and banking sectors, but is spare on specific details and the process for implementation. Under the Act, various regulatory agencies are charged with developing the rules and regulations necessary to implement the law's provisions, with the largest share assigned to the Securities and Exchange Commission (SEC). By design, the administrative rulemaking process involves the input of interested parties affected by the rules. The multitude of interested parties affected by the Act and complexity of the issues involved add to the urgency and enormity of the rulemaking task, for both the regulator and the regulated. Not surprisingly, many affected entities, particularly in the financial services industry, have already started evaluating the impact of the Act and the impending regulations to come. For the financial sector, awareness of the rulemaking process is critical for meaningful participation in drafting of these rules, and appropriate planning for their eventual

implementation. This article will discuss the rulemaking process generally, and specifically, for the SEC under the Act, as well as how this process affects regulated entities and other interested parties.

Overview of the Rulemaking Process

Since the New Deal programs of the 1930s, administrative agencies have been charged with promulgating rules to implement a broader statutory mandate. Today, key pieces of legislation function primarily as enabling statutes, with the details of administration and implementation delegated to the rulemaking process by government agencies. The Administrative Procedures Act (APA) governs the administrative rulemaking process, defining the steps that agencies must complete for substantive

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rulemaking and delineating the standard of judicial review.¹

The multitude of interested parties affected by the Act and complexity of the issues involved add to the urgency and enormity of the rulemaking task, for both the regulator and the regulated.

The process for rulemaking under the APA requires an agency to publish a proposed rule in the Federal Register at least 30 days prior to its effective date.² This notice of the proposed rule must set forth “either the terms or substance of the proposed rule or a description of the subjects and issues involved, and give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation.”³ Most agency regulations, including those contemplated by the Act, are developed and become effective using this “informal” Notice and Comment process. In some instances, the originating legislation dictates a more formal process, which typically includes both prior publication of the proposed rule and a public hearing.

The purposes of the Notice and Comment process are to (1) expose agency regulations to diverse public comment; (2) ensure fairness to affected parties; and (3) provide affected parties “an opportunity to develop evidence in the record to support their objections... and thereby enhance the quality of judicial review.”⁴ Ideally, the rulemaking process under the Act will provide a channel for experts and affected parties to educate the SEC and other agencies on information that might otherwise be overlooked.

Following the Notice and Comment period, the text of the final rule is published in the Federal Register and codified in the Code of Federal Regulations (CFR).⁵ The final rule is not required to undergo a separate Notice and Comment period for changes from the proposed rule, unless

the final rule “cannot fairly be viewed as a logical outgrowth of the initial proposal.”⁶ Although the agency is not required to respond to all comments, often the final rule is accompanied by a description of the issues raised by public comments and the agency’s responses, as well as how the final rule may have been modified as a result.

With respect to informal rulemakings, the APA requires that the agency “incorporate in the rules adopted a concise general statement of their basis and purpose.”⁷ The statement of the basis and purpose provision “does not require the agency to supply specific and detailed findings and conclusions..., but rather requires the agency to publish a statement of reasons that will be sufficiently detailed to permit judicial review.”⁸

The intended purpose of the Notice and Comment process underscores the importance of participating in the rulemaking process, particularly for entities that are uniquely affected by certain regulations.

When an agency promulgates a substantive rule pursuant to Congressional authorization and in keeping with the requirements of the APA, the final rule has the force and effect of law. Conversely, when an agency does not comply with the Notice and Comment requirements of the APA, courts may vacate the rule as invalid.⁹ Following the promulgation of final rules, interested parties may challenge the validity of the rule in federal court. Courts review agency actions under an arbitrary and capricious standard.¹⁰ While courts will defer to an agency’s determinations, particularly when the rule involves the agency’s area of expertise and is based on “highly complex and technical matters,” the APA requires that agency rulemaking be logical, rational and supported by the record.¹¹ To this end, judicial review is confined to the administrative record at the time of the agency’s decision, with certain limited exceptions.¹²

The intended purpose of the Notice and Comment process underscores the importance of participating in the rulemaking process, particularly for entities that are uniquely affected by certain regulations. Often, companies within an affected industry will defer to trade association or industry groups, but comments by such groups tend to cover the broader issues that affect all members. Individualized comments by firms pursuing their specific views or concerns should thus be considered. For those entities that do participate directly in the Notice and Comment process, the most effective arguments are often made in conjunction with the views of well-known academic experts and influential commentators. Outside of the official rulemaking process, using the media and lobbying Congressional oversight committees can have an indirect, but potentially effective, impact on rulemaking. Politics may also play a role, as policy advocacy groups and partisan think tanks will often participate in the process. For any company facing the prospect of significant changes to the way it does business as a result of the Act, strategic participation in the rulemaking process is of critical importance.

SEC Rulemaking under Dodd-Frank

Among the various financial regulators charged with implementing the Act, the SEC has the largest share of the work. It has been tasked with approximately 95 rulemakings and 17 studies and reports, many of which must be completed within one year. SEC rulemaking involves many of the most significant provisions of the Act, including:

- regulation of the derivatives markets;
- new requirements for proxy access and other corporate governance reforms;
- registration and reporting requirements for hedge funds and private equity firms;
- oversight of credit rating agencies; and
- implementation of whistleblower provisions and new enforcement tools.

The deadlines in these various legislative provisions vary, with some requiring the SEC to issue

rules within 180 days while others allow up to 12 months or more. The SEC and the Commodities Future Trading Commission (CFTC) have already moved quickly on certain provisions, such as the necessary definitions for new derivatives regulation.¹³

Given the magnitude and timing requirements for this rulemaking process, the SEC announced the unusual step of seeking preliminary public comments on a number of key provisions, in advance of the official Notice and Comment process. Typically, the SEC, pursuant to the requirements of the APA, seeks public comments at the same time that it publishes proposed rules. This preliminary comment process is available in addition to the official Notice and Comment process, which will commence upon publication of proposed rules. Given the number and complexity of rules the SEC must draft and the short time-frame imposed by the legislation, the Commission has opted to commence the process immediately by providing electronic means for interested parties to submit preliminary comments on specific issues.

Given the magnitude and timing requirements for this rulemaking process, the SEC announced the unusual step of seeking preliminary public comments on a number of key provisions, in advance of the official Notice and Comment process.

The SEC has made available on its website a series of dedicated email addresses covering a variety of issues related to impending rulemaking.¹⁴ The email addresses are organized by topic and title section. As with comments submitted during the official Notice and Comment process, all preliminary comments will be publicly available. The SEC has required electronic submission of any preliminary comments, which will be posted in their entirety on a dedicated section of the SEC website. Comments received are already available on the SEC website. Note that the SEC does not remove any personal identifying information from submissions. Parties wishing to submit com-

ments must be aware that anything contained in their comments will be made publicly available. Below is a chart (Fig. 1) setting forth the topics

for which the SEC has requested preliminary comments.

Fig. 1: Electronic submission of preliminary comments for SEC rulemaking

Title II—Orderly Liquidation Authority

- Orderly Liquidation of Covered Broker-Dealers

Title III—Transfer of Powers to the Comptroller of the Currency, the Corporation, and the Board of Governors

- Office of Minority and Women Inclusion

Title IV—Regulation of Advisers to Hedge Funds and Others

- Systemic Risk Reporting
- Exemptions for Certain Advisers
- Family Offices Exclusion
- New Threshold for Federal Registration
- Accredited Investor Standard

Title VI—Improvements to Regulation of Bank and Savings Associations Holding Companies and Depository Institutions

- Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds
- Conflicts of Interest Relating to Certain Securitizations

Title VII—Wall Street Transparency and Accountability

- Definitions (including “swap,” “security-based swap,” “security-based swap agreement,” “mixed swap,” “security-based swap dealer,” and “major security-based swap participant”)
- Security-Based Swap Dealers and Major Security-Based Swap Participants
- Mandatory Clearing of Security-Based Swaps, End-User Exception and Security-Based Swap Clearing Agencies
- Mandatory Exchange Trading and Swap Execution Facilities
- Governance and Conflict of Interest Controls for Clearing Agencies, Swap Execution Facilities and Exchanges

- Swap Data Repositories
- Real-Time Reporting
- Anti-Manipulation Protections

Title VIII—Payment, Clearing, and Settlement Supervision

- SEC Rulemakings under Title VIII

Title IX—Investor Protection and Improvements to the Regulation of Securities

- Study—Enhancing Investment Adviser Examinations
- Office of the Investor Advocate
- Pre-Sale Disclosures to Customers
- Pre-Dispute Arbitration
- Whistleblower Award Program
- Adding Disqualification Requirements to Regulation D Offerings
- Short Sale Disclosure
- Credit Rating Agencies Review and Rulemaking
- Asset-Backed Securities
- Executive Compensation (shareholder voting, executive compensation disclosures, voting by brokers, incentive-based compensation, and other compensation related matters)
- Loan or Borrowing of Securities/Securities Lending Activities

Title XV—Miscellaneous Provisions

- Specialized Disclosures (conflict minerals, mine safety, and payments by resource extraction issuers)

Other

- Other Initiatives to be Undertaken by the SEC in Response to the Dodd-Frank Wall Street Reform and Consumer Protection Act

In addition to the electronic submission of preliminary comments, the SEC has also announced “newly-established best practices” for meetings with interested parties.¹⁵ Under these best practices, the SEC Staff will endeavor to meet with any interested parties and, when this is not feasible, will seek meetings with parties holding varying viewpoints. To accomplish this, the SEC has stated that its Staff may need to limit meetings with similarly situated parties and multiple meetings with the same party. The Staff will also reach out to “affected stakeholders who do not appear to be fully represented by the developing public record on a particular issue.”¹⁶

The SEC’s new rulemaking best practices will also provide greater public disclosure of meetings with the Staff. Those who request a meeting with the Staff will be asked to provide an agenda, and the agenda will become part of the public record following the meeting. Meeting participants will also be “encouraged to submit written comments to the public file, so that all interested parties have the opportunity to review and consider the views expressed.”¹⁷ The intent of these new best practices is to “provide expanded opportunity for public comment and greater transparency and accountability” in the rulemaking process.¹⁸

The SEC has also announced that public hearings will be held on selected topics, although such hearings are not mandated by the Act or the informal rulemaking process of the APA. Already, the SEC Staff has hosted a roundtable, in conjunction with the CFTC, to discuss “issues related to governance and conflicts of interest in the clearing and listing of swaps and security-based swaps.”¹⁹ Interested parties should remain alert to further announcements regarding hearings, roundtables and other opportunities to provide input to the SEC’s rulemaking under the Act.

Beyond seeking preliminary comment, the SEC and other regulators are moving quickly to commence the official rulemaking process. For example, the SEC and CFTC, as part of their joint rulemaking required under the Act, have already published proposed rules to define key terms in Title VII, the Wall Street Transparency and Accountability Act (WSTA).²⁰

Timing and Implementation

Given the fast pace adopted by the SEC and other regulators, affected entities should plan now for the new regulations, both by getting involved in the rulemaking process as well as by preparing for implementation once final rules are issued.

A number of interested parties, particularly large financial institutions, have already commenced preparations for implementing the Act. Even before the bill was signed into law on July 21, certain financial firms were evaluating the impact of anticipated provisions on their business model and consulting their advisors regarding participating in the rulemaking process. Many firms are allocating significant new resources to their compliance and legal groups, in preparation for handling the increased regulatory burden.²¹ For example, firms have formed working groups organized around the significant provisions of the Act, that are tasked with monitoring the developing regulations, assessing the impact on the firm’s businesses and implementing necessary changes to the business structure or operations. And, even though the rulemaking process under the Act is only in its early stages, some firms have already announced significant structural changes, estimated the amount of increased expenditures or lost revenues, or made the decision to spin-off or cease operating certain businesses.

For firms that are not as far along in their analysis, an important first step is to prepare an overall roadmap of the impact of the Act on its business. This would include a comprehensive review of the firm’s entire business in order to identify each of its units, their structure and activities, and relationship to the rest of the organization. A thorough outline of the business in this manner allows the legal or compliance department, or outside counsel, to assess the specific impact of the Act on the firm, and prioritize the most important provisions, and in turn, the most important rulemaking for the particular firm. Some aspects of the Act may require less substantial changes, such as allocating additional resources to certain compliance functions, or changing reporting lines within the organization. Other provisions may require considerable strategic thinking regarding

the fundamental business model and structure of the firm. By determining the key provisions of the Act, and how those provisions will affect each unit and the business as a whole, a firm can more efficiently assign resources and personnel to monitor and participate in the rulemaking process and eventually implement changes required by the final rules.

Firms that engage in such strategic planning will also be able to focus their comments on the proposed rules that will have the greatest impact on their business. As to these proposed rules, firms should be prepared to propose revisions that would meet the goals of the SEC while minimizing the costs for firms and their customers. The SEC may be receptive to arguments about the hidden costs or unintended consequences of proposed rules.

While certain rulemaking is proceeding quickly, the entire process under the Act will take the better part of the next year to complete. Whether a firm uses outside counsel or other advisors, internal resources or both, the process of monitoring and implementing changes required by these regulations will require immediate project management and organization. The best approach is to consider the entire impact systematically from the outset, create documentation and tools that can be used to monitor the firm's priorities and progress, and employ the necessary resources to implement necessary changes.

Conclusion

The extensive and expedited rulemaking required of the SEC and other agencies under the Act presents an unprecedented challenge for both the regulators and the regulated. The entire rulemaking process will require dedication of resources, time, attention and focus. Moreover, it is all moving quickly. Although there are deadlines for implementation set in the statute, the SEC has shown a willingness to propose and finalize regulations even more quickly. It is important to remember that the statutory deadlines are outer limits, not a schedule, and many regulations may be issued sooner than required. Based on the pre-

liminary actions taken by the SEC, it is clear that some of the key provisions are on a fast track.

Affected firms should evaluate their own business and assign resources now to prepare for, and participate in, the SEC rulemaking process, as well as the eventual implementation of the resulting regulations.

NOTES

1. 5 U.S.C.A. §§ 551 *et seq.*
2. 5 U.S.C.A. § 553. The Federal Register is the official source for proposed rules, final rules, other administrative agency notices and executive orders and is updated on a daily basis. An electronic, searchable version is available online at <http://www.gpoaccess.gov/fr/>.
3. *Chamber of Commerce of U.S. v. S.E.C.*, 443 F.3d 890, 899, Fed. Sec. L. Rep. (CCH) P 93740 (D.C. Cir. 2006).
4. *AFL-CIO v. Chao*, 496 F. Supp. 2d 76, 91, 183 L.R.R.M. (BNA) 3110, 154 Lab. Cas. (CCH) P 10876 (D.D.C. 2007); see also *Sprint Corp. v. F.C.C.*, 315 F.3d 369, 373 (D.C. Cir. 2003).
5. An electronic, searchable version of the CFR is available at <http://www.gpoaccess.gov/cfr/>.
6. *First American Discount Corp. v. Commodity Futures Trading Com'n*, 222 F.3d 1008, 1015 (D.C. Cir. 2000) (internal quotations omitted).
7. 5 U.S.C.A. § 553(c)
8. *Schiller v. Tower Semiconductor Ltd.*, 449 F.3d 286, 297-298, Fed. Sec. L. Rep. (CCH) P 93873 (2d Cir. 2006).
9. *Chamber of Commerce*, 443 F.3d at 908.
10. *NetCoalition v. S.E.C.*, Fed. Sec. L. Rep. (CCH) P 95823, 2010 WL 3063632 at *5 (D.C. Cir. 2010)
11. *NetCoalition*, 2010 WL 3063632 at *10; *Chamber of Commerce*, 443 F.3d at 899-900.
12. See, e.g., *Fund for Animals v. Williams*, 391 F. Supp. 2d 191, 196 (D.D.C. 2005).
13. Securities and Exchange Commission, Commodity Futures Trading Commission, Release No. 34-62717, File No. S7-16-10 (Aug. 20, 2010).
14. "SEC Chairman Schapiro Announces Open Process for Regulatory Reform Rulemaking," SEC Press Release No. 2010-135 (July 27, 2010).
15. SEC Press Release No. 2010-135.
16. SEC Press Release No. 2010-135.
17. SEC Press Release No. 2010-135.
18. SEC Press Release No. 2010-135.
19. "SEC, CFTC to Host August 20 Roundtable on Clearing and Listing of Swaps and Security-Based Swaps," SEC Press Release No. 2010-148 (Aug. 13, 2010).

20. The SEC and CFTC proposed rules were published in the Federal Register on Aug. 20, 2010, which means that the final rules may become effective 30 days later, or as early as September 19, 2010.

21. The SEC is also expected to hire 800 additional personnel, in part, because of its substantial role in Dodd-Frank rulemaking and in response to its increased regulatory oversight of the derivatives market, hedge funds, and credit rating agencies.

Speaking at the recent annual meeting of the American Bar Association, the Director of the SEC's Division of Corporation Finance stated that the SEC is in "good shape" to keep up with the extensive rulemaking required under Dodd-Frank, while still pursuing its existing regulatory priorities. Meredith Cross, Remarks at American Bar Association Annual Meeting (San Francisco, Aug. 9, 2010).