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REGULATORY REFORM

SEC and CFTC Joint Rulemakings Under Dodd-Frank – A Regulatory Odd Couple?

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By now it is a commonplace that the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] requires dozens of agency and interagency implementing rulemakings. Less understood is how difficult it was to design a viable process for two widely respected agencies, the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC"), to engage in joint rulemakings to implement Title VII, which governs the regulation of derivatives. Was the process difficult because the CFTC and SEC are so different in their regulatory approaches, or is the job expected of them so daunting that extensive ground rules are essential to the task? A review of the alternatives that Congress considered and rejected can help a curious reader appreciate how Congress expects the SEC and the CFTC to share the responsibility for the regulation of a huge, previously unregulated market in financial instruments.[2]

Introduction

As Congress determined to regulate the swaps markets, it needed to resolve two competing policy goals: a desire for efficient, *i.e.*, consistent regulation of the swaps markets, and respect for the differing natures of those markets and their constituent products. The trade-off gives rise to a related question: should there be one regulator of U.S. financial markets, or is there room for two regulators, the CFTC and the SEC?[3]

A merger of the two agencies had intellectual appeal; the regulation of markets internationally often is en-

[1] Public Law No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank").

[2] "Landmark Financial Regulatory Reform Legislation Passed By U.S. Congress," dated July 20, 2010, available at http://www.shearman.com/landmark-financial-regulatory-reform-legislation-07-20-2010/.

[3] Whether or not coincidentally, at the height of legislative consideration of the joint rulemaking proposals, the two agencies formed a Joint CFTC-SEC Advisory Committee to facilitate regular communication between the agencies and promote regulatory harmonization. *See* SEC Release No. 33-9123 (May 10, 2010). Notwithstanding this demonstration of cooperative spirit, as described below, Congress still elected to impose on the two agencies a more formal regime of joint rulemaking.

trusted to a single regulator.[4] This approach recognizes the similarities between products and markets and reduces the opportunity for regulatory arbitrage. At the same time, the presence of two agencies can effectively recognize the differences inherent in multiple products and markets. Because the idea of a formal agency merger lacked sufficient political appeal, a compromise was struck; a de facto merger of regulatory principles and mechanics through joint rulemaking came closest to achieving increased efficiency in regulation, while simultaneously preserving the status quo.

SEC and CFTC Jurisdiction

To appreciate how Congress finally settled on joint rulemaking to resolve those competing concerns, one first must appreciate the sometimes conflicting nature of the jurisdiction of the SEC and the CFTC.[5] It is convenient to think of the SEC's jurisdiction as based purely on the regulation of securities, and the jurisdiction of the CFTC involving only the regulation of commodity futures, but that formulation ignores the middle ground. Rather than dispute authority over instruments that closely resemble securities or futures, the two agencies typically have concentrated jurisdictional disputes on instruments that sit in the gray area in the middle of the regulatory or product spectrum.

Shad Johnson Accord. An early example of agency conflict in this gray area occurred when the SEC and the CFTC disputed jurisdiction over futures contracts based on securities. The resolution of this dispute, known as the Shad-Johnson Accord (''Accord''), was brokered by the Chairmen of the SEC and CFTC in 1981 and then reflected in the Securities Acts Amendments of 1982[6] and the Futures Trading Act of 1982.[7] Under the Accord, jurisdiction over securities and securities indices (and options thereon) went to the SEC, and jurisdiction over futures on securities (including futures based on securities indices and exempt securities, and options thereon) to the CFTC.[8] The Accord also prohibited the trading of futures on individual stocks (*i.e.*, single stock futures) and narrow-based indices of securities.[9]

The Swap Markets. The most recent example of jurisdictional conflict between the two agencies involves the swap markets, which grew explosively over the last few decades. At first there was no direct regulation of the swap markets at the federal level because Congress was satisfied to employ indirect regulation: the major participants in the markets, banks, securities firms, and their affiliates, already were regulated directly by the bank regulatory agencies or the SEC.[10] The CFTC recognized this approach by exempting most of these instruments from its regulatory oversight in the early 1990s.[11]

Over time, the increasing size of the swaps markets continued to draw Congressional and regulatory scrutiny, but Congress confirmed its endorsement of the indirect regulation model. In 2000, rather than divide jurisdiction over swaps between interested regulators, the CFMA excluded bilaterally traded swaps between sophisticated parties from regulatory oversight. The exclusion was based on the belief that most swaps were not susceptible to manipulation and most swap counterparties were sophisticated participants who did not require regulatory protection in what functioned as a *wholesale* market.[12]

The CFMA also directed the Federal Reserve, the Secretary of the Treasury, the CFTC, and the SEC to study issues regarding the offering of swaps to *retail* customers, including the appropriate regulatory structure, if any, to address related customer protection issues. Congress directed the agencies to submit with the report any recommendations for legislative action. The agencies, however, were unable to agree on a division of jurisdiction and they declined to provide recommendations concerning the regulation of retail swaps.[13]

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[4] The following countries have only one regulator for their entire financial system, including markets: Austria, Bahrain, Belgium, Cayman Islands, Czech Republic, Denmark, Estonia, Finland, Germany, Gibraltar, Hungary, Iceland, Ireland, Japan, Kazakhstan, Latvia, Maldives, Malta, Nicaragua, Norway, Poland, Singapore, South Korea, Switzerland, Sweden, Taiwan and UAE. *See* Elizabeth Brown, ''A Comparison of the Handling of the Financial Crisis in the United States, the United Kingdom and Australia,'' 55 Vill. L. Rev. 509, 512 (2010). In the wake of the financial crisis, much of the discourse has criticized the single regulator model, and promoted the ''twin peaks'' model in place in Australia and New Zealand. None of the discourse, however, has promoted a move to the functional regulation model in place in United States markets.

[5] The problems of conflicting jurisdiction are exacerbated by conflicting agency cultures, as the agencies interpret and apply similar rules differently. There are well recognized, distinct differences in the cultures and regulatory approaches of the SEC and the CFTC: the SEC approach tends to be rules-based, while the CFTC approach is principles-based. *See* Department of Treasury,''Financial Regulatory Reform: A New Foundation,'' (June 17, 2009) (''*Financial Regulatory Reform: A New Foundation*''), at 50.

[6] Public Law No. 97-303, 96 Stat. 1409 (1982).

[7] Public Law No. 97-444, 96 Stat. 2294 (1982).

[8] Shad-Johnson did not end jurisdictional conflict over securities futures, however. In 1989, the agencies tussled in the courts over futures that were based on securities indices and traded on securities exchanges, with the Seventh Circuit finding that the CFTC should have exclusive jurisdiction over any product that combined elements of both futures and securities products. *See Chi. Mercantile Exch. v. Sec. & Exch. Comm'n*, 883 F.2d 537 (7th Cir. 1989).

[9] The prohibition on the trading of single stock futures was not lifted until the enactment of the Commodity Futures Modernization Act of 2000 (''CFMA''), which mandated joint CFTC/SEC oversight of single stock futures and futures on narrow-based security indices. Notwithstanding the Accord, joint agency cooperation in this arena has proceeded slowly, most particularly with respect to an agreement on margin requirements.

[10] The SEC regulated the derivative activities of the largest securities firms through the Consolidated Supervised Entity program, which was introduced in 2004 and terminated in 2008.

[11] Acting under authority of the Futures Trading Practices Act of 1992, the CFTC exempted from regulation under the Commodity Exchange Act nonstandardized swap agreements entered into between eligible swap participants that were not entered into or traded on or through a multilateral transaction execution facility. *See* 17 C.F.R Part 35.

[12] Department of Treasury, ''Blueprint for a Modernized Financial Regulatory Structure'' (March 2008) (''Bush Blueprint'').

[13] Board of Governors of the Federal Reserve System, Department of Treasury, Commodity Futures Trading Commission and Securities Exchange Commission, ''Joint Report on Retail Swaps'' (Dec. 2001).

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Given this history, an observer could have anticipated that at some later point the agencies and ultimately Congress would have to confront the issue of dividing authority over the world of swaps. The somewhat nervous arrangement where bank regulatory agencies indirectly regulated the swap markets was only a stopgap that did not anticipate and could not control the events leading to the financial crisis of 2008.

SEC and CFTC Merger

Following the devastating effects of the financial crisis, there was general acceptance that the previously unregulated market for swaps should or would be subjected to formal regulation.[14] That general understanding did not extend to the division of jurisdiction between the market regulators. The immediate question for resolution was whether to pursue a merger of the SEC and CFTC or permit a continuation of the *status quo*, and in that event, how were the two agencies to coexist?

Administration Proposals. As the crisis unfolded, policymakers dusted off longstanding recommendations to deal with the CFTC/SEC dispute over jurisdiction by recommending not only the harmonization of securities and futures regulation, but also the merger of the CFTC and the SEC into one entity. The Bush Administration proposal dealt with the underlying cultural divide by calling for a merger of regulatory philosophies, with the CFTC's principles-based approach surviving.[15]

By the time the Obama Administration's Treasury Department announced its policy position on the outlines of financial regulatory reform, the outright calls for consolidation of the two agencies had subsided. Instead, the SEC and CFTC would maintain their current responsibilities and authorities as market regulators, and there would be a focus on harmonizing the statutory and regulatory frameworks for futures and securities.[16]

The text of the Administration's legislative proposal served as a starting point for the Congress in enacting Dodd-Frank. This proposal called for extensive joint rulemaking by the SEC and CFTC, including definitions, and capital and margin rules. Joint rulemakings were to be uniform. In the absence of uniformity, the Treasury would be empowered to make the rules.[17] Some observers have called the harmonization process a ''synthetic merger.''

Congressional Action. In Congress, the calls for a merger of the CFTC and SEC similarly were louder at first and subsided over time. Instead of legislating an agency merger, there was a provision in the House bill, as passed, calling for a joint study by the SEC, CFTC, and Treasury of the desirability and feasibility of establishing a single regulator for all transactions involving financial derivatives by January 1, 2012.[18] The Senate bill as introduced called for a study by the Comptroller General of how the CFTC and the SEC implemented the derivatives title, the extent to which jurisdictional disputes created challenges in implementing the title, and the benefits and drawbacks of harmonizing laws implemented by the CFTC and SEC and merging those agencies.[19] References to these studies, however, disappeared from the Senate bill and Dodd-Frank as enacted.

There was initial enthusiasm for requiring the SEC and CFTC to adopt identical implementing rules for the regulation of swaps and security-based swaps, which also diminished. Both the House and the Senate bills, when first introduced, called for joint rulemakings on a broad range of issues, beyond definitions[20] to registration and regulation of dealers and major swap (and security-based swap) participants.[21] At first, joint SEC and CFTC rulemakings were required to have ''uniform'' results. In the absence of agreement on uniform rules, Treasury (or, in the Senate bill, the FSOC) would promulgate implementing rules.[22]

As time progressed, the requirement for uniformity in joint rulemakings was deleted from both bills passed by the House and the Senate. Also, the number of joint rulemakings was whittled down, so that only the definitional rulemakings, rules relating to record-keeping[23] and rules relating to capital and margin requirements[24] were required to be joint. FSOC's tiebreaker authority was limited in the final bill. Apparently, uniformity (and the potential for ceding rulemaking authority to Treasury) was not politically palatable to the SEC and CFTC, their constituent groups, or their Congressional oversight committees.[25]

One might ask at this point why Congress had the luxury of so many choices in determining how the SEC and CFTC were to adopt joint rules and why the Administrative Procedure Act (''APA''), for example, would not control the form that a joint rulemaking should take.[26] The simple answer is that the APA does not even address the subject of joint rulemaking. Few courts have dealt with the issue and, as discussed below, judicial guidance on the subject is sparse and not instructive.

Dodd-Frank and the Resolution of Jurisdiction

The final version of Dodd-Frank drew bright, but general lines of authority, giving the SEC jurisdiction over all security-based swaps and the CFTC jurisdiction

[14] The most obvious precipitant of Congressional action was the failure of AIG, an entity that accumulated extraordinarily large positions in credit default swaps but had escaped even indirect regulation.

[15] Bush Blueprint, *supra*, at 106-112.

[16] *Financial Regulatory Reform: A New Foundation*, *supra*.

[17] Obama Administration's combined draft legislation for Financial Regulatory Reform (available at http://www.llsdc.org/attachments/files/252/Dodd-Frank-Act_Admn-Reg-Reform-Bill.pdf) (''*Obama Legislative Proposal*'') § 711(c).

[18] H.R. 4173 as passed on December 11, 2009, § 3005(c).

[19] S.3217, as introduced on April 15, 2010, § 763.

[20] H.R. 4173 as introduced on December 2, 2009, § 3101(b); S.3127 as introduced on April 15, 2010, § 711(b)(1).

[21] H.R. 4173 as introduced on December 2, 2009, § 3107; S.3127 as introduced on April 15, 2010, § 717.

[22] H.R. 4173 as introduced on December 2, 2009, § 3101(c); S.3127 as introduced on April 15, 2010, § 711(c).

[23] Section 712 of Dodd-Frank.

[24] Section 731 of Dodd-Frank.

[25] This approach is a far cry from that taken in the Financial Services Regulatory Relief Act of 2006 (Public Law No. 109-351, 120 Stat. 1966 (2006)), when Congress required the SEC and the Federal Reserve to jointly issue a *single* set of rules or regulations to define the term ''broker'' in accordance with section 3(a)(4) of the Securities Exchange Act of 1934.

[26] Public Law, 79-404, 60 Stat. 238, 5 U.S.C 551.

over all other swaps, much as the Administration originally proposed. The question naturally follows, at what point along a theoretical continuum does a swap end and a security-based swap begin? Given that the definitions of 'swap' and 'security-based swap' are to be fleshed out by agency rulemakings, this task effectively requires the agencies to agree to demarcate their own jurisdiction.

Congress did recognize the difficulty of the task confronting the two agencies and their history in dealing with other jurisdictional issues, and created an extensive framework to govern the rulemaking process. However, the Title VII framework for joint rulemaking raises as many questions as it answers.

Joint Rulemaking. Section 712 of Dodd-Frank governs how the CFTC and the SEC may adopt rules implementing Title VII, and it mandates cooperation. At a minimum, the agencies cannot individually adopt rules with the effect of intruding on each other's turf.[27] Instead, the SEC and the CFTC must consult and coordinate on all Title VII rulemakings within their jurisdiction, plus obtain (and presumably incorporate) the views of ''prudential'' regulators.[28] There is a distinction between rulemakings that are still required to be joint (generally those involving definitions), and those remaining rulemakings subject to a presumably less stringent standard of consultation and coordination.[29]

The items subject to the joint rulemaking requirement include:

- Definitions of swaps, security-based swaps, security-based swap agreements;
- Definitions of swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, eligible contract participant;
- Books and records regarding security-based swap agreement;
- Definition of mixed swaps[30]
- Other matters that the two agencies choose to subject to joint rulemaking.

Congress gave only a limited and perhaps conflicting explanation of what a joint rulemaking is: joint rules shall be comparable to the maximum extent possible, taking into account differences in instruments and applicable statutory requirements. The two agencies must treat similar products in a similar fashion, but there is no obligation that the agencies treat such products identically.[31] Reading these provisions together, a joint rulemaking seems to require closer coordination and a more similar outcome than a mere consultative, coordinated rulemaking, but joint rules need not achieve identical results for similar products.

Congress anticipated and attempted to prevent a regulatory end-run, by which one agency could subsequently issue an interpretation to undercut a joint rule. There is a requirement that any subsequent interpretation or guidance by the SEC or CFTC concerning items subject to joint rulemaking shall be effective only if issued jointly by the two agencies after consulting with the Federal Reserve. To make the agencies' task still more difficult, Congress required that the joint rules be adopted within 360 days of Dodd-Frank's enactment, or July 16, 2011.[32]

Provisions Weakening Joint Rulemaking Requirements. In addition to progressively weakening the concept of joint rulemaking, as the legislative process went on, Congress simultaneously adopted provisions in Title VII anticipating and perhaps encouraging the SEC and CFTC to engage in a less than harmonious joint rulemaking process.

First, Title VII affirms that each of the two agencies can unilaterally bring actions to enforce its jurisdiction.[33] Implicit in the authority to enforce a law is the ability to interpret that law. This affirmation seems to undercut, if not directly conflict with, the Title VII limitation preventing the two agencies from independently asserting jurisdiction in the swaps arena. Even assuming a successful joint rulemaking dividing jurisdiction, over time the number and scope of differences in interpretations of those rules by the agencies may become magnified. Notwithstanding the language limiting improper assertions of jurisdiction, it is difficult to foresee situations where one agency could credibly rush to protect an industry participant from enforcement of Dodd-Frank by the other.

Second, although Dodd-Frank requires that these several definitional rules be adopted jointly, there are parallel provisions that specifically permit the CFTC and the SEC, respectively to further define the term ''swap'' and ''security-based swap,'' to capture products that have been structured to evade the requirements of Dodd-Frank.[34] Whereas the Administration proposal and the bill as introduced in the Senate provided for joint anti-avoidance rulemakings, the final provisions contain no reference to a joint exercise.[35] Statutory provisions ordinarily should be interpreted *in pari materia*, to give effect to all relevant provisions; notwithstanding the general requirement of consultation for all Title VII rulemakings, however, either agency arguably could rely on the final anti-avoidance provisions as a means of enlarging its jurisdiction and avoiding joint action.

Third, while it is clear that the DC Circuit may not accord deference to an agency rule that is subject to challenge by the other agency, Dodd-Frank does not ad-

[27] Section 712(a) of Dodd-Frank.

[28] The term ''prudential regulators'' refers to the banking regulatory agencies that have jurisdiction over any swap dealer, security-based swap dealer, major swap participant or major security-based swap participant that is a bank. The participation of the prudential regulators in the regulation of the swaps markets will diminish markedly as the provisions of Dodd-Frank come into effect, because most swap dealers will become futures commission merchants that are regulated by the CFTC.

[29] Section 712(a). This terminology apparently was borrowed from provisions such as Section 241 of the Gramm-Leach-Bliley Act of 1999 (Public Law No. 106-102, 113 Stat. 1338 (1999)) relating to inter-agency coordination and, assuming there is a difference between the two terms, was presumably more politically palatable than requiring further rules to be made ''jointly.''

[30] While the requirement to issue joint rules regarding the definition of ''mixed swaps'' appears in Section 712(a)(8) of Dodd-Frank, all other references requiring joint definitional rulemakings are found in Section 712(d) of Dodd-Frank. One possible explanation for this discrepancy is that the definition of ''mixed swaps'' was added as an afterthought.

[31] Section 712(a)(7)(B) of Dodd-Frank.

[32] Section 712(e) of Dodd-Frank.

[33] Section 712(a)(4) of Dodd-Frank.

[34] Sections 721(c) and 761(b)(3) of Dodd-Frank.

[35] *Obama Legislative Proposal*, *supra*, § 711(b)(2); S.3127 as introduced on April 15, 2010, § 711(b)(2).

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dress the degree of deference that courts should accord to the SEC and CFTC when *subsequently* interpreting or administering the rules that they jointly adopt. Interpretations of Title VII requirements must be jointly adopted in order to be effective, but it is unlikely that the two agencies could act quickly in providing joint interpretations and a market participant would be foolhardy to ignore an interpretation issued by either agency alone. This omission effectively weakens the overarching emphasis in Title VII that similar products be treated similarly and essentially forces market participants to comply with practically-different, if not conflicting, SEC and CFTC interpretations of joint rules.

Dispute Resolution Mechanisms. Dodd-Frank creates two mechanisms to address and resolve situations where the SEC and the CFTC cannot agree in their joint rulemakings, but both processes have profound weaknesses.

If the SEC and the CFTC cannot agree to adopt rules jointly, at the request of either agency, the Financial Stability Oversight Council (''FSOC'') may act as ''tie-breaker'' and can side with either agency's rulemaking approach or broker a compromise position.[36] Dodd-Frank does not specify the process that the FSOC must follow in making such a determination; the FSOC need only consider relevant information, make a determination within a reasonable timeframe, and provide the agencies a written explanation for its decision.[37] FSOC determinations are made by a super-majority vote of two-thirds of FSOC members and are not binding.[38] Moreover, it is not clear that the FSOC mechanism precludes an aggrieved agency from bringing a court challenge to a joint rulemaking. One wonders if this non-binding FSOC procedure will ever be used.

There is a separate, extensive scheme for either agency to initiate a judicial challenge of final rules issued by the other agency, *e.g.*, in situations where one agency may claim that the other agency has adopted rules that encroach upon its own jurisdiction[39] or if one agency disagrees with the other agency's categorization of a novel derivative product.[40] In these circumstances, the offended agency can apply for expedited judicial review by the Court of Appeals for the District of Columbia Circuit (''DC Circuit'').

While providing a judicial review mechanism in Title VII may make sense on its face, there are numerous disadvantages to such an approach. A reviewing court would find it difficult to overturn one agency's rulemaking solely because it differs from that of the challenging agency. A court may resist intervening in what it considers a political question and instead assert that the agencies or the FSOC should properly resolve the matter.[41] Should the DC Circuit entertain a case, ordinarily it would defer to agency interpretation of any ambiguous provision in Title VII, recognizing the agency's unique ability to interpret statutes that the agency administers.[42] Dodd-Frank precludes the DC Circuit from giving deference, however, where either the SEC or CFTC challenges the rulemaking of the other agency.[43] This provision both reinforces a court's obligation to issue an even-handed ruling, and makes review more difficult.

Interpretive Dilemmas. In the end, Congress attempted to resolve its conflicting policy goals by choosing both: promote uniformity in rulemaking and maintain the functional regulatory split between the SEC and the CFTC. In the process of making this ''compromise,'' Congress raised a host of interpretive questions. On the one hand, Congress appears to have recognized that different products and markets can serve as economic substitutes and that if the agencies adopt rules that leave gaps or are inconsistent, there is a danger of regulatory arbitrage by exploitation of these gaps and inconsistencies. Hence Congress required the adoption of similar, joint rules. On the other hand, by not requiring uniform rulemaking, Congress seems to have empowered the agencies to permit such arbitrage opportunities. Does joint rulemaking in its present form prevent arbitrage and encourage the SEC and CFTC to implement a policy of increased regulation in a previously unregulated area or is it a subterfuge to allow the markets to pick their own regulator or avoid regulation altogether?

Do the joint rulemaking provisions in Title VII operate as a mechanism to promote a *de facto* merger of the two agencies or do they simply preserve the *status quo*? Agency lawyers may parse the legislative text to justify any of a number of regulatory approaches along a continuum, to require only loose consultation between the agencies, or to require the agencies to adopt rules that are as close to identical as possible, or something in between. We can infer that joint rules are closer on the continuum to identical rules than consultative rules, but is that the only way to interpret the two rulemaking alternatives? Is there merely a linguistic, rather than a substantive difference between the two? Is there an objective standard we can apply? Unfortunately, there is little in the way of helpful judicial guidance as to what is meant by a joint or a consultative rulemaking.[44]

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[36] Section 712(d)(3) of Dodd-Frank. The FSOC is a new regulatory entity created by Dodd-Frank to identify risks to financial stability, promote market discipline, and respond to emerging threats to financial stability. *See* Section 112(a) of Dodd-Frank.

[37] Section 119(c) of Dodd-Frank.

[38] Section 119(d) of Dodd-Frank.

[39] Section 712(c) of Dodd-Frank.

[40] Section 718(b) of Dodd-Frank.

[41] At least one court has expressed frustration in a case where the SEC and the CFTC previously were unable to resolve their jurisdictional differences consensually. *See, e.g.*, *SEC v. Sentinel Management Group, Inc*. (U.S.D.C., N.D. Ill. Aug. 20, 2007) (transcript of the proceedings at 27, available at http://www.sentinelcommittee.com/pdfs/1100.pdf). (''Why doesn't this agency of the government go over and talk to this agency of the government and get your act together, for crying out loud . . . These are two agencies of the United States of America. Why don't you talk to each other and sort it out.''). One can expect that the DC Circuit similarly would not welcome the opportunity to review and resolve two dueling approaches that should be ''joint.''

[42] This principle is memorialized in *Chevron, U.S.A., Inc. v Natural Resources Defense Council, Inc.*, 467 US 837 (1984), and is often referred to as ''Chevron deference''.

[43] Section 712(c)(3)(A) of Dodd-Frank.

[44] For example, a court considered what is required for consultative agency action in the environmental law field, and gave very little direction. In *Washington Toxics Coalition v. U.S. Dept. of Interior, Fish and Wildlife Services*, 457 F. Supp.2d 1158 (W.D. Wash. 2004), the court chose not to decide the issue, finding that an unclear, unspecific statute on the process of consultation left it to the agency's discretion ''to create a range of types of consultation.'' While acknowledging

Practical Considerations. The absence of guidance in Title VII concerning the scope of joint rulemaking means that one must resort to practical considerations to discern how ''joint'' a joint rulemaking must be. One can foresee instances in which agency staffs compromise and cooperate to adopt nearly identical, final rules that will be binding on all market participants. A different, more contentious process might be followed, however, with endless exchanges of draft regulations but no agreement as to substance. Differences in approach could intensify over time. After a notice and comment period, the two agencies could simply announce the adoption of widely discrepant but ''jointly issued'' rules. One of the two agencies could challenge the other agency's rule, or both could declare the process a success.

Most likely, agency rules will be deemed to be sufficiently joint when the two agencies agree to pronounce that the rules satisfy that standard, regardless of the substantive differences in those rules, simply to avoid the prospect of embarrassing litigation. There are few venues available in all but the most egregious cases to challenge instances where the agencies agree that a rulemaking is joint. Industry participants could challenge the agencies, but there may be an inherent hesitancy to bring one's regulator to court if the alternative regulator participated in the process and agrees with the challenged result. Legislative oversight committees can challenge rulemakings as contrary to Congressional intent in enacting Dodd-Frank, through requiring the testimony of agency heads, but that approach is less effective when, as now, the two houses of Congress are controlled by different political parties.

Progress to Date

It is too early to assess the results of the SEC's and the CFTC's joint rulemakings, but not surprisingly the two agencies already have stressed that they are working closely and cooperatively together.[45] In December 2010, the SEC and CFTC tackled the easier half of their task by publishing for notice and comment proposed rules further refining the terms ''swap dealer,'' ''security-based swap dealer,'' ''major swap participant,'' and ''major security-based swap participant.'' The two agencies have not yet addressed in a published proposal, however, the more difficult half of their joint rulemaking obligation, refining the definitions of the terms ''swap,'' ''security-based swap,'' and ''mixed swap,'' and ''security-based swap agreement.''[46] The first group defines market *participants*, while the second set essentially and more importantly defines the *markets* themselves.

We now have a better understanding of how the agencies interpret the boundaries of the term ''joint,'' and large degrees of difference can be tolerated. Although the December proposals were issued jointly, they are by no means identical. For example, the CFTC's proposed rule identifies a ''major swap participant'' as an entity that has ''a current uncollateralized exposure of $5 billion, or a combined current uncollateralized exposure and potential future exposure of $8 billion, across the entirety of an entity's swap positions.''[47] In contrast, the SEC's companion rule identifies a ''major security-based swap participant'' as an entity with ''a current uncollateralized exposure of $2 billion, or a combined current uncollateralized exposure and potential future exposure of $4 billion, across the entirety of an entity's security-based swap positions.''[48] More recently, the SEC and the CFTC proposed companion rules regarding security-based swap execution facilities and swap execution facilities, but they differed fundamentally. The SEC approach[49] would allow a market participant to trade in security-based swaps after requesting a quote from only a single dealer, whereas the CFTC' would require a market participant using a swap execution facility to request quotes from at least five dealers before engaging in trade.[50] If both rules are adopted without change, there could be a large difference in transparency and liquidity between the swaps and security-based swaps markets.[51] The CFTC and the SEC may choose to align their final rules on swap execution facilities to avoid this result or they may coordinate by choosing simply to treat their respective constituent markets differently.

The agencies have also declared that they are aware of the risks inherent in joint and consultative rulemakings. In nodding to the principle of reducing the potential for regulatory arbitrage, the CFTC and SEC recently asked in a notice of proposed rulemaking if their two approaches are comparable or different, and whether any difference is likely to have any impact on market participants. The agencies also asked whether their regulatory approaches will require duplicative or inconsistent efforts by market participants subject to both regimes or result in regulatory gaps.[52] It remains to be seen how market participants will react to those questions and how the SEC and the CFTC will incorporate those comments in final rules.

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this wide discretion, the court warned that the agencies must consult in some form nonetheless. *Id*. at 1179. It is quite possible that a court considering the requirements for a joint rulemaking could give equally unclear guidance to the CFTC and SEC about how to approach ''jointness.''

[45] *See*, *e.g*., Testimony of CFTC Chairman Gary Gensler before the House Committee on Agriculture, Subcommittee on General Farm Commodities and Risk Management (Dec. 15, 2010).

[46] On August 13, 2010, the two agencies issued an advance notice of proposed rulemaking (''ANPR'') in which they invited public comment on how to further define those terms subject to joint rulemaking, but without giving any preliminary indication as to how they would approach the task. In the ANPR, the agencies simply encouraged commenters to address aspects of the definitions such as the extent to which the definitions should be based on qualitative or quantitative factors and what those factors should be, any analogous areas of law, economics, or industry practice, and any factors specific to the commenter's experience. The comment period closed on September 20 and the agencies have not taken further action on the matter. *See* CFTC RIN 3235-AK65, SEC Release No. 34-62717, 75 Fed. Reg. 51429 (Aug. 20, 2010)

[47] CFTC RIN 3038–AD06; SEC Release No. 34–63452; 75 Fed. Reg. 80173, 80198 (Dec. 21, 2010).

[48] *Id*.

[49] SEC Release No. 34–63825, 76 Fed. Reg.10948 (Feb. 28, 2011).

[50] CFTC RIN 3038–AD18, 76 Fed. Reg.1214 (Jan. 7, 2011).

[51] *See*, *e.g*., Financial Times Article *SEC at Odds with CFTC on Swap Trade Rules* by Michael Mackenzie and Aline van Duyn, February 3, 2011.

[52] *See, e.g*., SEC Release No. 34–63556 (Dec. 15, 2010) regarding end-user exceptions to mandatory clearing of security-based swaps.

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Conclusion

As the markets become increasingly innovative with swaps products, the line between the SEC's and the CFTC's jurisdiction becomes increasingly blurred. While the SEC and the CFTC have a history of jurisdictional conflict over swaps, such conflict is wasteful of agency resources, retards innovation, and potentially damages the competitiveness of the United States financial markets. A spectrum of solutions to this jurisdictional conflict has been proposed, ranging from merger of the agencies to informal cooperation. Title VII of Dodd-Frank represents a political compromise on the issue, by requiring the SEC and the CFTC to adopt some rules jointly, and others in consultation. Dodd-Frank also includes dispute resolution mechanisms, anticipating fears that the SEC and the CFTC will be unable to agree on how to regulate swaps.

The joint rulemakings in Title VII can be viewed as an experiment as to whether the SEC's and CFTC's cultural differences can be overcome, at least to the extent of regulating swaps. From one perspective, if the rulemakings are sufficiently joint to be perceived as successful, one could infer that a template has been created for additional Congressional mandates that will naturally lead to a synthetic merger of the agencies. A failure to adopt joint regulations would reinforce perceptions that the status quo must continue because the markets are so different.

There is, however, a second, perhaps counterintuitive interpretation of the results of this experiment. A joint rulemaking process that is truly effective and result in more efficient market regulation could make the case *against* merging the agencies in the future; the two agencies will have proved they can coexist successfully and efficiently. If, however, the process disintegrates into litigation or recrimination, the case for more effective regulation through agency merger may be stronger.

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