Dismantling Dodd-Frank: The Road Ahead

Among the many campaign promises of the 45th President of the United States, the repeal of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or DF) may not have captured the popular imagination as firmly as his undertakings to build the wall or to bring manufacturing jobs back to America did. Nevertheless, for structured finance lawyers it is the promise that is most anxiously monitored with mixed degrees of concern and anticipation. Concern, because of the confusion and uncertainty that even a carefully orchestrated repeal will inevitably entail; anticipation, because of the work volumes that such confusion and uncertainty will hopefully spur.

The chart below summarizes some of the main Dodd-Frank provisions affecting securitizations, and examines some potential avenues for reform or repeal. Before getting into the specifics of the chart, however, a few high-level thoughts may be helpful.

First, It would be a mistake to assume that a simple repeal of Dodd-Frank (whether in part or in its entirety) would suffice to restore the regulatory regime in effect at the onset of the financial crisis. For example:

- In situations where Dodd-Frank repealed a pre-existing regulation (e.g., former Rule 436(g), promulgated by the Securities and Exchange Commission (the **SEC**) under the Securities Act of 1933, as amended (the **Securities Act**), which protected rating agencies from being regarded as "experts" for purposes of the liability provisions of the federal securities laws), a repeal of Dodd-Frank itself would not automatically revive the repealed regulation. Instead, further regulatory action would need to be taken.
- In addition, when Dodd-Frank added new language to a pre-existing statute (e.g., the addition of a new Section 13 to the Bank Holding Company Act of 1956, which mandates the enactment of the Volcker Rule regulations, or the insertion of new language in Section 15(d) of the Securities Exchange Act of 1934, which eliminated the automatic suspension of on-going reporting obligations under that statute for asset-backed issuers), the effect of a repeal of Dodd-Frank on the amended pre-existing statute is less clear.
- Finally, in instances where Dodd-Frank required federal agencies to adopt regulations that those agencies could arguably have adopted in exercise of their pre-Dodd-Frank regulatory powers (e.g., SEC regulations requiring securitizers to perform a review of the assets being securitized), these regulations would survive a simple repeal of Dodd-Frank. However, in instances where federal agencies relied solely on the authority granted by Dodd-Frank to adopt regulations, these regulations may no longer be enforceable following a repeal of Dodd-Frank.

Second, in certain instances it may be possible to obtain relief from the regulatory constraints introduced by Dodd-Frank through more than one avenue (e.g., amending or repealing legislation, amending existing regulation, or agency interpretive action). The selection of the course of action to be pursued in a particular instance will involve multiple considerations, including:

- Under the appropriate circumstances (i.e., when Democratic support can be enlisted to foreclose the potential for a filibuster in the Senate, and the House radical conservatives can be appeased), legislative relief could potentially be obtained significantly faster than any of its regulatory alternatives since the legislative process is not subject to the lengthy notice and comment period requirements that surround most agency action.
- Depending on the subject matter involved, however, it may be more appropriate to pursue individual regulatory reforms with the relevant departments

or agencies (particularly in circumstances where an alternative regulatory regime is sought to be adopted to replace repealed provisions of Dodd-Frank). As the experience under Dodd-Frank demonstrated, when intricate subjects are involved or politically charged, there may be a preference within Congress to not prescribe detailed statutory specifics, but rather to delegate to the relevant agencies the substantive content and mechanics of implementing the policy objective. Unfortunately, this can result in a lack of meaningful guidance as to the intended parameters of the enacted law (and resulting regulation).

– A corollary of the foregoing is that technical matters are more likely to be addressed by lobbyists directly to the agency in charge of the corresponding regulation.

Third, in most instances where legislation is not possible or appropriate and changes are needed to existing securitization regulations, under the Administrative Procedure Act (**APA**) the process of amending or repealing regulation is treated identically to origi nal rule-making for purposes of the required notice and comment process, unless either (i) the proposed changes consist of interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice or (ii) the relevant agency for good cause finds that notice and comment on such amendment or repeal are impracticable, unnecessary, or contrary to the public interest (in which case the APA allows the rele vant agencies to dispense with notice and comment requirements).

Given this framework, a combination of fast-paced legislative repeal followed by slow-moving regulatory replacements of the discarded regime could lead to several years of uncertainty and confusion.

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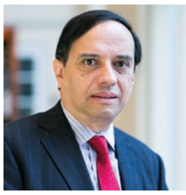

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Appendix

Securitization regulation reform avenues

Provision	Potential Reform Avenue(s)	Observations
Dodd-Frank Required Regulations		
Title IX, Subtitle D (Improvements to the Asset-Backed Securitization Process)		
Conflicts of interest regarding certain securitizations (DF § 621) (prohibiting underwriters, placement agents, initial purchasers and sponsors of ABS from engaging in transactions that would result in material conflicts of interest with respect to any investor in such ABS for a period of one year following the closing date):		
– Rule 127B (proposed on September 19, 2011; not yet adopted).		Given that this rulemaking was mandated by Congress, a withdrawal of the proposed rule (without further rulemaking on this issue implemented or at least planned) may be inappropriate. A repeal of this section of Dodd-Frank would remove any urgency that the SEC may have to complete this rulemaking process (although the SEC probably has inherent authority to adopt the proposed rule even in the absence of a DF-based mandate).
Credit risk retention (DF § 941) (requiring issuers and sponsors of ABS to retain an economic interest in a material portion of the credit risk for any asset that, through the issuance of an asset-backed security, they transfer, sell, or convey to a third party):		Given the important and widely-acknowledged policy drivers behind the risk retention requirements, coupled with the international commitment of the U.S. in the wake of the financial crisis to implement some form of risk retention, complete repeal of the requirement is likely neither appropriate nor probable.
– Regulation RR adopted on October 20, 2014 by the six federal agencies subject to the mandate.	– Legislation to repeal or amend Exchange Act § 15G. – Joint agency rulemaking to revise existing regulations in order to address industry-identified pain points.	Paragraph (e)(1) of § 15G appears to require that any "exemptions, exceptions or adjustments" to the rules adopted thereunder need to be jointly adopted by all the agencies involved in the initial rulemaking. If this interpretation prevails, any effort to seek regulatory amendments would be more challenging. As of the date of this writing, the staff of the SEC has issued two no-action letters regarding requirements of Regulation RR. In both instances, the staff indicated that it had consulted the positions taken with colleagues at the other agencies.
		While a complete overhaul of the current Risk Retention regime may be difficult to achieve and time consuming to undertake, some specific revisions that directly affect securitization may be more easily achievable. For example:
		– The agencies could revise the criteria for Qualifying Automobile Loans to be more consistent with the auto finance business, as provided in comments to the proposed rule.
		– With respect to externally managed CLOs, there may be lender and investor support for the legislative removal of the Risk Retention Requirement.

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		– A simple legislative amendment would suffice to ensure that offshore transactions that meet the risk retention guidelines of the European Union are entitled to claim substituted compliance when sold in the U.S.
Suspension of Exchange Act on-going reporting obligations for ABS issuers (DF § 942(a)) (carving out ABS from the suspension of on-going reporting obligations for issuers of securities with less than 300 holders):		
– Rules 12h-3, 12h-6 and 15d-22 and Form 15 amended on August 17, 2011.	– Legislation to amend Exchange Act § 15(d). – SEC rulemaking to change the current regime.	Because § 942(a) of Dodd-Frank amended § 15(d) of the Exchange Act to carve out ABS issuers from the general provision allowing issuers with less than 300 holders to suspend their reporting obligations, a repeal of Dodd-Frank § 942(a) that does not expressly restore 15(d) to its pre-Dodd-Frank language may not automatically bring back the old regime (in which case, additional rulemaking would be required).
ABS loan-level data disclosure (DF § 942(b)) (requiring the adoption of rules to (i) set asset-level disclosure requirements to enable investors to perform due diligence on assets and (ii) set standards for the format of data provided by ABS issuers):		
– Items 1111(h) (Asset-Level Information) and 1125 (Schedule AL) of Regulation AB added on September 4, 2014 as part of Regulation AB II.	– SEC rulemaking to repeal or amend current regime. – No-action relief or interpretive guidance may be available to address more targeted industry-identified pain points.	Items 1111(h) and 1125 of Regulation AB would survive a repeal of Dodd-Frank § 942(b) since they were not adopted exclusively under the authority of § 942(b). Prior to Dodd-Frank, the SEC had the authority to require asset-level disclosure (and had, in fact, proposed such a requirement for all assets in its 2010 proposal to amend Regulation AB).
Representations and Warranties in ABS Offerings (DF § 943) (requiring promulgation of rules directing (i) rating agencies, to describe transaction representations, warranties and enforcement mechanisms and their differences with those in other transactions involving similar securities; and (ii) securitizers, to disclose fulfilled and unfulfilled repurchase requests):		
– New Rules 15Ga-1 and 17g-7 and amendments to Item 1104 (Sponsors) and 1121 (Distribution and Pool Performance Information) of Regulation AB adopted on January 20, 2011.	– SEC rulemaking to repeal or amend the current regime. – Congressional hearing to re-evaluate efficacy of rulemaking under DF §§ 932(a), 943, and 945.	Rules 15Ga-1 and 17g-7 would survive a repeal of Dodd-Frank § 943 since they were adopted, not only under § 943, but also in reliance on the SEC's general rulemaking authority under the Exchange Act.
		Now that there are several years of practical experience with these rules, it may be appropriate to revisit them through a public hearing or other method to analyze whether the investor protection provided is worth the cost to the industry (and, indirectly, to the cost of credit in the real economy) of complying with these regulations.

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Due diligence analysis and disclosure in ABS issues (DF § 945) (requiring promulgation of rules directing issuers of ABS to perform a review of the underlying assets and disclose the nature of such review to investors):		
– Rule 193 and amendments to Item 1111 of Regulation AB adopted on January 20, 2011.	– SEC rulemaking to repeal or amend the current regime. – See above with respect to rules adopted under DF §§ 932(a), 943, and 945.	Rule 193 and the amendments to Item 1111 would survive a repeal of Dodd-Frank § 945 since they were adopted not only under § 945, but also in reliance on the SEC's general rulemaking authority under the Exchange Act.
Title VI (Improvements to the Regulation of Banks)		
Volcker Rule (DF § 619) (prohibiting banking entities from proprietary trading and from sponsoring, owning or retaining an ownership interest in covered funds):		
– Final joint rule adopted on December 10, 2013. – Final Commodity Futures Trading Commission rule adopted on January 31, 2014.	– Legislation to amend or repeal Section 13 of the Bank Holding Company Act of 1956, as amended (the **BHC**). – Rulemaking to revise existing regulations. One potential solution would be simply to exclude any entity that exclusively issues securities meeting the Exchange Act definition of "asset-backed security" from the definition of "covered fund" in the Volcker Rule. This would clarify the common-sense position that the purpose of the Volcker Rule was not to deter securitization activity.	The OCC, the FDIC, the SEC and the Commodity Futures Trading Commission ("CFTC") adopted the Volcker Rule solely on the authority of Section 13 of the BHC. With respect to these agencies, a repeal of Section 13 would appear to make the corresponding regulations unenforceable. The FRB, on the other hand, adopted the Volcker Rule not only on the authority of Section 13 of the BHC, but also relying on its regulatory authority under the Federal Reserve Act, the Federal Deposit Insurance Act and the International Banking Act of 1978, as amended. A repeal of Section 13 of the BHC alone would leave doubts as to which provisions of the Volcker Rule would survive under the authority of these other statutes.
		If Section 13 of the BHC is not repealed, amendments to the Volcker Rule regulations may be complicated. Because the existing regulations were simultaneously adopted by four federal agencies, there is a question as to the different agencies' ability and willingness to independently revise their own regulations. Further questions are raised as to how the separate CFTC rule will complicate any revisions to the existing regulations.
Title VII, Part II (Regulation of Swap Markets)		
Margin (DF §§ 731 and 764) (requiring implementation of rules establishing capital requirements and initial and variation margin requirements for swap entities on all non-cleared swaps and non-cleared security-based swaps):		
– Final Rules adopted by the OCC, the FRB, the FDIC, the Farm Credit Administration and the Federal Housing Finance Agency published on November 30, 2015 (80 FR 74840).	– Rulemaking to revise existing regulations. – No action or exemptive relief.	
– Final Rules adopted by the CFTC on December 18, 2015 (81 FR 636). – SEC proposed rules (October 18, 2012)		

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Title IX, Subtitle C (Improvements to the Regulation of Credit Rating Agencies)		
Disclosure of Third-Party Due Diligence Services (DF § 932(a)) (requiring third-party due diligence providers for ABS to provide written certification to rating agencies and requiring that these reports be made publicly available):		
– Rules 15Ga-2 and 17g-8 to 17g-10 adopted on August 27, 2014.	– SEC rulemaking to repeal or amend the current regime. – See above with respect to rules adopted under DF §§ 932(a), 943, and 945.	Rules 15Ga-2 and 17g-8 to 17g-10 would survive a repeal of Dodd-Frank § 932(a) since they were adopted not only under § 932(a), but also on reliance on the SEC's general rulemaking authority under the Exchange Act.
Study and Rule-Making on Assigned Credit Ratings (DF § 939F, also known as the Franken Amendment) (requiring that the SEC carry out a study of (i) the credit rating process for structured finance and related conflicts of interest and (ii) the feasibility of establishing a program in which a third party assigns rating agencies to determine the credit ratings for structured finance products).		The study was submitted to Congress in December 2012. In 2014 when the final rules on rating agencies were announced, no reference was made to forthcoming rules under § 939F. As the SEC has not yet taken action to propose a rule, it seems unlikely that a rule will be proposed; however, it is unclear whether this may be a part of the SEC rulemaking agenda going forward.