FedFin Client Report

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FedFin Analysis: Is the SEC Planning a Push-Out Pull Back?

Client Report: PUSH-OUT14

Executive Summary

As we noted, SEC Chairman Gensler's written Senate Banking testimony included a short – but very significant – statement prioritizing Commission review of key fixed-income market sectors. This did not come up at the hearing (see *Client Report* **INVESTOR18**), which focused on hot partisan issues such as climate risk and cryptoassets. However, the extent to which the SEC renews efforts to govern fixed-income activities it now thinks too far outside its reach has significant strategic implications, most immediately for large banks that might find key underwriting and capital-markets activities under additional standards and greater enforcement risk. In this report, we assess what Mr. Gensler contemplates for the corporate, muni, and asset-backed securities (ABS) markets, revisiting the "push-out" battles the Commission largely lost over a decade ago to evaluate whether the Fed could or would defend banks again from demands that key activities register with the SEC. Activities under possible SEC scrutiny could include primary dealers, securities lending, custody, and the interactions between banks and affiliated asset managers that sparked FSOC interest in 2015 (see Client Report **ASSETMANAGEMENT2**).

Analysis

In his testimony, the SEC chairman said:

> Further, I've asked staff to reconsider some initiatives on Treasury trading platforms, and also to consider how to level the playing field by ensuring that firms that significantly trade in this market are registered as dealers with the SEC. … Additionally, I've asked staff for recommendations on how we can bring greater efficiency and transparency to the non-Treasury fixed income markets — corporate bonds, a $11 trillion market; municipal bonds, a $4 trillion market; and asset-backed securities (which

> back mortgages, automobiles, and credit cards), a $13 trillion market. This market is so critical to issuers. It is nearly 2.5 times larger than the commercial bank lending of about $10.5 trillion in our economy.

We note that Mr. Gensler's comments were so brief as to permit various interpretations. For example, some believe the chairman was referencing expanded reach for a 2020 rewrite of certain disclosures now required only of micro-cap and similar issuances aimed at retail markets. However, these rules expressly exclude the muni market, which is as noted also mentioned by Mr. Gensler.

We thus revisit the push-out battle, one the Commission lost to its considerable consternation. The 1999 Gramm-Leach-Bliley Act (GLBA) established what it called a "functional-regulation" approach to assigning regulatory jurisdiction in financial holding companies (FHCs) allowed to engage in banking, securities, and insurance activities. This authority extended not only to separately-incorporated subsidiaries within the FHC, but also often to activities housed in such subsidiaries. Thus, for example, a broker-dealer that took retail deposits could be considered a bank subject to a federal banking regulator and a bank engaged in certain activities could be considered a broker-dealer by the SEC. GLBA exempted some in-bank activities from the SEC's reach and a series of rules thereafter battled over what had to be "pushed out" of a bank into the SEC's hands.

The Commission's initial rules following GLBA (see Client Report **PUSHOUT4**) took a very tough approach, essentially forcing "push-out" of a wide array of activities deemed securities into registered broker-dealers. This sparked strong protests from both banks and banking agencies, leading Congress in 2006 to demand that the SEC and FRB to design a more consensual jurisdictional regime (See FSM Report **REGRELIEF25**). A 2007 joint FRB-SEC rule (See FSM Report **PUSHOUT13**) then established the current framework, one that became effective in 2008 and largely forgotten outside compliance shops ever since.

Apart from statutory restrictions, there are few impediments to the SEC moving now to rewrite the 2007 rule or address any areas it thinks neglected by all of the prior rules evident now in recent market developments. Any changes to existing rules would of course require a public notice-and-comment rulemaking, but the Commission could initiate new jurisdictional claims via actions ranging from new rules to enforcement actions that might then face litigation eventually establishing the perimeters of Commission and bank-regulatory jurisdiction.

All that is clear now is that the SEC chairman has new standards in his sights.

Federal Financial Analytics, Inc.
2101 L Street, NW – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com