Section 848 of the Financial Choice Act 2017: Unwise at any Speed (Part 2)

This series of posts examines the misguided efforts of the House Financial Services Committee to reform the existing process for issuing exemptive orders pursuant to Section 6(c) of the Investment Company Act of 1940. Section 848 of the pending Financial Choice Act 2017 would attempt to accelerate the process of obtaining exemptive orders by forcing the SEC to grant or deny an exemptive application within a fixed time frame. My prior post discussed the current process of obtaining an exemptive order. This post examines the problem at which Section 848 appears to be aimed. A later post will explain why it misses its mark.

Long Delays When Seeking Exemptions

Every practitioner in this area can recite examples of long waiting periods, sometimes stretching into years, for a decision from the SEC staff. Such a delay can have highly adverse competitive effects on an applicant. In general, there are at least three reasons for these delays. First, many applications raise novel policy issues that need to be carefully thought through by the SEC staff and the commissioners. The public interest and best means of protecting investors may not be as obvious as the applicant may believe, so it often takes time to for the Division of Investment Management (Division) to reach a decision on whether to grant the order and, if so, on what conditions to attach. In addition, reflecting on earlier exemptive orders may prompt the SEC staff to reconsider policies as they address subsequent applications seeking the same exemptions. It would be irresponsible for the SEC not to learn from what it has done and to make adjustments accordingly. Second, the ability to issue exemptive orders on a serial basis ironically undercuts the incentive the SEC has to reduce the number of applications, and thus its workload, by adopting rules providing exemptions that would be available to a broad class of potential applicants. Many exemptive orders that have been granted serially (such as ETFs and inter-fund lending) have become so routinized that they are ripe for rulemaking. (Indeed, an ETF rule was in fact proposed but never adopted.) But codification of exemptive applications often takes a back seat to what are perceived as more urgent matters (such as money market fund reform or liquidity risk management) the SEC cannot address through the individual exemptive order process. Senatorial foot dragging on confirming commissioners has also impeded the rulemaking process. Finally, individual exemptive applications must be reviewed and vetted by different levels of staff within the Division, who may have to consult with other Offices or even Divisions, and who may not all agree about the nature or scope of the exemptive relief being sought. This "socialization" process within the Division necessarily slows the progress that any individual exemptive application can make, but, in light of the profound policy and competitive implications of granting exemptions from statutory prohibitions, it is important for the SEC to exercise disciplined oversight over its exemptive authority. If the alternative was to give an individual staff member unchecked power to rescind portions of the 1940 Act based on his or her own judgment, the result would be chaotic, unpredictable, and unfair, even if one were to assume that no serious damage was being done to investor protection.

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