REGULATING THROUGH THE BACK DOOR AT THE COMMODITY FUTURES TRADING COMMISSION

The traditional method of regulating under the Administrative Procedure Act (APA)—the law that governs regulatory agency rulemaking—requires a notice-and-comment process, where the regulating agency informs the public of its proposed rule, seeks feedback from the public and interested parties, and performs a benefit-cost analysis of the proposed rule. These requirements boost public confidence in the regulatory process and allow regulated businesses to prepare for and understand new rules, which leads to better compliance.

In recent years, many federal agencies—including the Commodity Futures Trading Commission (CFTC)—have sought to regulate through less formal and rigorous options, such as guidance documents, staff letters, and settlement agreements with businesses targeted under enforcement actions. These "backdoor rulemaking" methods rarely seek feedback from the public and interested parties, are subject to change with little notice, and may even violate the APA because their requirements often bind industries to make mandatory changes or risk agency enforcement actions against them.

In a new study for the Mercatus Center at George Mason University, scholar Hester Peirce shows that such methods undermine public confidence in the regulatory process and harm regulated industries' compliance efforts due to uncertain requirements and an ever-changing regulatory landscape. By examining the recent actions of the CFTC, Peirce shows that the agency has created a confusing, ad hoc approach to regulation that excludes viewpoints, damages compliance efforts, and undermines the agency's ability to regulate certain financial markets.

To read the full study, see "Regulating through the Back Door at the Commodity Futures Trading Commission."

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BACKGROUND ON THE CFTC, DODD-FRANK, AND REGULATORY RULEMAKING

Dodd-Frank Imposes New Rule-Writing Requirements on the CFTC

In response to numerous rule-writing assignments and aggressive deadlines in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) requiring the CFTC to regulate the over-the-counter derivative market called "swaps," over the past several years the CFTC has significantly increased its issuance of new rules and staff letters. (Staff letters respond to specific inquiries from regulated businesses about their obligations under the law.)

CFTC's Use of Backdoor Rulemaking

The CFTC is likely using backdoor rulemaking—guidance, staff letters, and enforcement action settlements—for reasons of expedience as well as a desire to avoid accountability. While there is uncertainty about the level of judicial deference appropriate to an agency's use of backdoor rulemaking, one thing is certain: the CFTC has taken the practice to a new level in an effort to meet the aggressive mandates and deadlines imposed by Dodd-Frank.

BACKDOOR RULEMAKING UNDERMINES CFTC REGULATORY EFFECTIVENESS

There are several problems with the CFTC's approach to regulation:

- *It lacks procedural rigor*. Benefit-cost analysis helps identify and mitigate unintended consequences, but backdoor rulemaking is not subject to this process. Additionally, failure to follow a standard process can undermine public confidence in administrative efficiency.

- *It is unpredictable and lacks transparency*. Businesses must piece together the voluminous amount of guidance, staff letters, and enforcement actions to discern how a regulation might affect them. Changing compliance dates right before the deadline also creates uncertainty in the market.

- *It is not deliberative*. Backdoor rulemaking leaves out commissioners and the public, and precludes careful crafting of clear, unambiguous rules. Moreover, rules that have the potential to radically change existing financial markets avoid judicial and congressional scrutiny.

CONCLUSION

While not every agency action, decision, or application to a particular set of facts needs to go through a formal commission process, new requirements that materially revise existing rules or change compliance dates should be submitted to the commission and subjected to the notice-and-comment rulemaking process. Congress can use its oversight authority to monitor and develop guidelines for agency use of backdoor rulemaking. Moreover, creating more generous and realistic deadlines for agencies to write new rules and more carefully drawn rulemaking mandates would help limit regulatory agency backdoor rulemaking.