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Client Alert

Government Matters

SEPTEMBER 24, 2018

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Echoes of the Brand Memo

Agencies Issue Statements Limiting the Use of Guidance Documents

Following the lead of the Department of Justice, several agencies issued statements disclaiming guidance as legally binding authority. The Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Bureau of Consumer Financial Protection issued an interagency statement on September 11, 2018, clarifying that "guidance does not have the force and effect of law, and the agencies do not take enforcement actions based on supervisory guidance."[1] Two days later, Chairman Jay Clayton of the Securities and Exchange Commission stated that "all staff statements are nonbinding and create no enforceable legal rights or obligations of the Commission or other parties."[2]

These announcements are part of a larger regulatory reform effort by the Trump Administration. One primary goal of that effort is to ensure that administrative enforcement actions rely on legally binding authority such as laws and regulations and that enforcement actions are not brought for "violations" of non-binding materials such as guidance or staff views. While the statements made by these agencies are a positive step in that direction, significant questions remain about the scope of the statements and how they will be implemented in practice. It is also unclear whether regulation through adjudication will be reined in, or whether that will become the outlet to address problematic conduct that could have been redirected by staff guidance.

I. FIRST MOVERS: EXECUTIVE ORDER AND THE DEPARTMENT OF JUSTICE

The President signed the Executive Order "Enforcing the Regulatory Reform Agenda" in early 2017,[3] which instructed agencies to reform their regulatory structures and reduce burdens on the American public. The Order specifically instructed agencies to review their "guidance documents,

policy memoranda, rule interpretations, and similar documents" with an eye for what should be eliminated.

On November 16, 2017, Attorney General Sessions issued a memorandum to all DOJ components entitled "Prohibition on Improper Guidance Documents."[4] The memorandum prohibits DOJ from issuing "guidance documents that purport to create rights or obligations binding on persons or entities outside the Executive Branch." Any guidance that is issued by DOJ must now "disclaim any force or effect of law, and avoid language suggesting that the public has obligations that go beyond those set forth in the applicable statutes or legislative rules." The Attorney General also instructed the Associate Attorney General to work with Department components to identify and rescind past guidance documents that are not consistent with the principles outlined in his memo.

On January 25, 2018, then-Associate Attorney General Rachel Brand issued a memorandum entitled "Limiting Use of Agency Guidance Documents in Affirmative Civil Enforcement Cases."[5] While the Sessions Memo limits DOJ's issuance of guidance documents, the Brand memo limits DOJ's use of guidance documents issued by any agency. The Brand Memo prohibits the civil litigating components of the Department and U.S. Attorneys' Offices from "us[ing their] enforcement authority to effectively convert agency guidance documents into binding rules." As such, Department litigators "may not use noncompliance with guidance documents as a basis for proving violations of applicable law in [affirmative civil enforcement] cases." The Brand Memo thus vindicates and elevates a common-sense principle: enforcement actions must be based on a violation of law, and non-binding guidance is not law.

II. INTERAGENCY STATEMENT CLARIFYING THE ROLE OF SUPERVISORY GUIDANCE

On September 11, 2018, the Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Bureau of Consumer Financial Protection issued an interagency statement following the lead of the Department of Justice. The interagency statement clarifies the role of supervisory guidance and outlines the ongoing efforts by the agencies to establish that role. The statement defines "supervisory guidance" to include "interagency statements, advisories, bulletins, policy statements, questions and answers, and frequently asked questions" that are directed toward the agencies' respective supervised institutions. The agencies recognize that supervisory guidance has a legitimate role to play in providing examples of practices the agencies consider consistent with safety-and-soundness standards, in outlining the agencies' priorities, and in providing transparency. Supervisory guidance does not, however, "have the force and effect of law and the agencies do not take enforcement actions based on supervisory guidance." As quoted below, the joint statement identified efforts to emphasize the proper role of supervisory guidance:

- The agencies intend to limit the use of numerical thresholds or other "bright-lines" in describing expectations in supervisory guidance. Where numerical thresholds are used, the agencies intend to clarify that the thresholds are exemplary only and not suggestive of requirements. The agencies will continue to use numerical thresholds to tailor, and otherwise make clear, the applicability of supervisory guidance or programs to supervised institutions, and as required by statute.
- Examiners will not criticize a supervised financial institution for a "violation" of supervisory guidance. Rather, any citations will be for violations of law, regulation, or non-compliance with enforcement orders or other enforceable conditions. During examinations and other supervisory activities, examiners may identify unsafe or unsound practices or other deficiencies in risk management, including compliance risk management, or other areas that do not constitute violations of law or regulation. In some situations, examiners may reference (including in writing) supervisory guidance to provide examples of safe and sound conduct, appropriate consumer protection and risk management practices, and other actions for addressing compliance with laws or regulations.

- The agencies also have at times sought, and may continue to seek, public comment on supervisory guidance. Seeking public comment on supervisory guidance does not mean that the guidance is intended to be a regulation or have the force and effect of law. The comment process helps the agencies to improve their understanding of an issue, to gather information on institutions' risk management practices, or to seek ways to achieve a supervisory objective most effectively and with the least burden on institutions.
- The agencies will aim to reduce the issuance of multiple supervisory guidance documents on the same topic and will generally limit such multiple issuances going forward.
- The agencies will continue efforts to make the role of supervisory guidance clear in their communications to examiners and to supervised financial institutions, and encourage supervised institutions with questions about this statement or any applicable supervisory guidance to discuss the questions with their appropriate agency contact.

III. STATEMENT REGARDING STAFF VIEWS

Two days later, on September 13, 2018, Chairman Jay Clayton of the SEC reemphasized in a public statement "[t]he Commission's longstanding position . . . that all staff statements are nonbinding and create no enforceable legal rights or obligations of the Commission or other parties." These staff statements take the form of written statements, compliance guides, letters, speeches, responses to frequently asked questions, and responses to specific requests for assistance. The Chairman stated that "public engagement on staff statements and staff documents is important and will assist the Commission in developing rules and regulations that most effectively achieve the SEC's mission." He also reiterated that "it is the Commission and only the Commission that adopts rules and regulations that have the force and effect of law."

Chairman Clayton instructed the Division of Enforcement and the Office of Compliance Inspections and Examinations to reinforce to the staff the distinction between staff views, which are not legally binding, and regulations and laws, which are legally binding. He also instructed the divisions and offices of the SEC that prior staff statements and documents should be reviewed to determine whether they should be modified, rescinded, or supplemented in light of recent developments. Later that day, Chairman Clayton supplemented his remarks to the SEC Investor Advisory Committee informing the Committee of his public statement regarding non-binding staff statements and noting that, "in connection with the upcoming Roundtable on the Proxy Process, the Division of Investment Management issued a statement withdrawing two 2004 letters to Egan-Jones Proxy Services (May 27, 2004) and Institutional Shareholder Services, Inc. (Sept. 15, 2004)."[6] These no action letters related to purported fiduciary obligations of investment managers to vote in elections by companies whose shares were within their assets under management. Withdrawing two no action letters, but not the many others in the SEC's library, suggests a role will remain for guidance from the SEC staff, even though the staff cannot speak for the Commission.

IV. IMPLICATIONS FOR ONGOING AND FUTURE ENFORCEMENT

These actions represent the latest effort by the Trump Administration to implement regulatory reform. Questions remain, however, about the scope of these statements. For example, the Interagency Statement provides that enforcement actions should not be taken based on supervisory guidance. On the other hand, examiners may point to supervisory guidance to highlight unsafe or unsound practices in risk management. Only a blurry line separates the bringing of an enforcement action based on a "violation" of a guidance—which is improper, since guidance is not law—and from the bringing of an enforcement action based on a violation of a statute or regulation as interpreted in a guidance. As a result, despite the recent statements, supervised entities may essentially be required to follow supervisory guidance even if the guidance itself is not couched as legally binding. The same may turn out to be true of numerical standards or bright lines contained only in guidance documents and described as merely "exemplary" but

used in practice to represent the agency’s interpretation of a statute or regulation. In such cases, it must be expected that many regulated entities will continue to tailor their behavior to avoid crossing those interpretive standards or lines. Thus, the influential effect of guidance will remain notwithstanding the statement. Finally, the statement notes that examiners will continue to look for violations of enforcement orders. Even if supervisory guidance documents are reduced and relied on less openly or frequently, regulation through adjudication may take the place of regulation by guidance.

The SEC statement is even more modest than the Interagency Statement. The express instruction that was given to the SEC staff was to “further emphasize th[e] distinction” between non-legally binding staff views and legally binding regulations and laws. Moreover, while direction was given to review past staff views and statements, the focus of that review seems to be to update them to reflect current market realities, not to eliminate them to reduce the regulatory burden on supervised entities. For many years, individual SEC Commissioners and SEC staff members consistently have clarified, when offering their views, that their views are their own and are not necessarily the views of the agency. Market participants hungry for guidance watch those statements closely, as do defense lawyers whose clients were attempting to follow the rules. If what results from this approach is less transparency into the Staff’s thought processes or guidance regarding complex rules and regulations, then many may not view that as a positive outcome. While the Chairman’s statement sends a strong signal to the staff to make sure they are not thinking of prior staff statements as binding on the Commission or on market participants, such non-binding statements will remain important and sometimes helpful to regulated actors attempting to remain compliant.

Even though questions about the scope of these agency statements remain unresolved, they continue a trend of administrative agencies returning to first principles regarding applying legally binding authority when engaged in law enforcement. It should go without saying that before an enforcement action may be brought to enforce a given prohibition, that prohibition must exist. Likewise, a guidance document cannot itself create a legal prohibition, because such a document is non-binding. The prohibition to be enforced, therefore, must have been created by a statute or a regulation. The difficulty arises where the statute or regulation is drawn in vague or general terms and guidance purports to interpret it. Drawing the line between guidance documents that genuinely (and reasonably) interpret an ambiguous prohibition contained in a statute or regulation and guidance documents that effectively create a prohibition may be difficult in practice, but that line is critical to the important interests at stake: ensuring that agencies cannot circumvent the rulemaking process and, most of all, that citizens have fair notice of what the law is before they can be subjected to an enforcement action for violating it. The recent statements should provide new bases for advocacy with the agencies. Companies and individuals will now have more support when attempting to dissuade staff level examiners and attorneys from pursuing theories of liability not clearly within statutory or regulatory text, and they may also have new avenues of appealing to agency leadership if staff are not dissuaded.

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[1] “Interagency Statement Clarifying the Role of Supervisory Guidance,” from the Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Bureau of Consumer Financial Protection, September 11, 2018, available at https://www.fdic.gov/news/news/press/2018/pr18059a.pdf (Interagency Statement).

[2] Chairman Jay Clayton, Statement Regarding SEC Staff Views, September 13, 2018, available at https://www.sec.gov/news/public-statement/statement-clayton-091318 (SEC Public Statement).

[3] Enforcing the Regulatory Reform Agenda, Exec. Order No. 13777, 82 Fed. Reg. 12285 (Feb. 24, 2017).

[4] “Memorandum: Prohibition on Improper Guidance Documents,” from Attorney General Jefferson Sessions, November 16, 2017, available at https://www.justice.gov/opa/press-release/file/1012271/download.

[5] “Memorandum for Heads of Civil Litigating Components, United States Attorneys: Limiting Use of Agency Guidance Documents In Affirmative Civil Enforcement Cases,” from Associate Attorney General Rachel Brand, January 25, 2018, available at https://www.justice.gov/file/1028756/download (“Brand Memo”).

[6] SEC Public Statement.