

**OVERSIGHT OF THE SECURITIES  
AND EXCHANGE COMMISSION: WALL  
STREET'S COP ON THE BEAT**

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**HEARING**  
BEFORE THE  
**COMMITTEE ON FINANCIAL SERVICES**  
**U.S. HOUSE OF REPRESENTATIVES**  
ONE HUNDRED SIXTEENTH CONGRESS  
FIRST SESSION

\_\_\_\_\_  
SEPTEMBER 24, 2019  
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## **OVERSIGHT OF THE SECURITIES AND EXCHANGE COMMISSION: WALL STREET'S COP ON THE BEAT**

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**Tuesday, September 24, 2019**

U.S. HOUSE OF REPRESENTATIVES,  
COMMITTEE ON FINANCIAL SERVICES,  
*Washington, D.C.*

The committee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Maloney, Sherman, Meeks, Clay, Scott, Green, Cleaver, Himes, Foster, Beatty, Vargas, Gottheimer, Tlaib, Porter, Axne, Casten, Pressley, McAdams, Dean, Garcia of Illinois, Garcia of Texas, Phillips; McHenry, Lucas, Posey, Luetkemeyer, Huizenga, Barr, Tipton, Hill, Emmer, Zeldin, Loudermilk, Davidson, Budd, Kustoff, Gonzalez of Ohio, Rose, Steil, and Gooden.

Chairwoman WATERS. The Financial Services Committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "Oversight of the Securities and Exchange Commission: Wall Street's Cop on the Block."

I now recognize myself for 4 minutes to give an opening statement.

Good morning. I want to welcome back Chairman Clayton, and welcome Commissioners Jackson, Peirce, Roisman, and Lee to this important hearing on the SEC's role in U.S. capital markets. This is the first time since 2007 that all 5 Commissioners of the Securities and Exchange Commission have testified before the Financial Services Committee.

I believe it is important for the committee to hear testimony from each of the Commissioners, including its Chairman, because they each hold a vote on important regulatory and enforcement matters, and they each hold unique views of which the committee should be aware. This is especially important since the SEC is not fulfilling its mission as Wall Street's cop.

Key rules like the Volcker Rule have been rolled back, while rules to implement other important reforms on issues like executive compensation, which Congress enacted back in 2010 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, remain incomplete. Other regulations, such as the SEC's so-called

regulation best interest (BI), failed to protect retirement savers from unscrupulous financial advisers.

It is also clear that our existing securities laws are not working, and there are loopholes in the laws that corporate insiders are taking advantage of. For example, executives are enriching themselves by buying or selling securities in their own companies during the 8-K trading gap, which is a 4-day gap after a major corporate event before the company is required to notify the public and investors of that event.

Corporate executives are also using stock buybacks to line their own pockets rather than giving their companies pay raises or investing in their companies. In addition, a court decision in *Kokesh v. SEC* limited the SEC's ability to recover wrongful gains from fraudsters like Bernie Madoff and return them to harmed investors.

I believe that the SEC needs stronger tools to protect investors and punish bad actors. Members of this committee have introduced a number of bills to strengthen the Commission and our securities laws, and a number of these bills have passed this committee or the full House. Today, we will have the opportunity to hear directly from the Commissioners on these important measures.

In addition, I am very concerned about Facebook's plan to create a digital currency, Libra, and a digital wallet, Calibra. It appears that Facebook is working to create a new global financial system that is intended to rival the U.S. dollar. I, and other Democrats on the committee, have called for Facebook to halt their plans until regulators in Congress have an opportunity to examine these issues and take action.

Today, I hope to hear what steps the SEC is taking to ensure that Libra is appropriately and rigorously regulated. I look forward to the testimony of our witnesses.

And I now recognize the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, for 5 minutes for an opening statement.

MR. MCHENRY. Thank you, Madam Chairwoman. Thank you for holding today's hearing. And I appreciate Chairman Clayton and the gang joining us today. It's interesting that the whole Commission is here.

The SEC has a three-part mission: protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. Now, all three pillars of the SEC's mission are critical, but I believe the first two pillars—protecting investors and maintaining fair, orderly, and efficient markets—are encapsulated in that third pillar, capital formation. For without capital formation, the other two could not exist.

And that means that if you have no market to regulate, then people won't have the opportunity to invest. Without markets for retail investors to participate in, there would be no need for investor protection. So, we need to help investors by focusing on policies that make our markets stronger, more attractive, and more competitive, not add regulatory costs and weaken them.

We don't have to look any further than the impact of mandatory disclosure after mandatory disclosure on a company's compliance costs. Those are real costs borne by real investors making it more

onerous and expensive to be public companies. Companies heavily burdened by cost will choose to stay in the private markets, ultimately depriving retail investors of choices and opportunities in the public markets.

To that end, I am glad that the SEC, under Chairman Clayton's leadership, is focused on long overdue reforms that focus on capital formation initiatives that benefit Main Street investors. The SEC's renewed commitment to revitalizing our public capital markets through increased capital formation could not come at a more appropriate and more crucial time.

When considering publicly traded companies in which to invest, American investors have roughly half the number of companies that they did compared to 20 years ago. To quote Chairman Clayton, the steady decline in the number of public companies in the U.S. is simply, "not good." That is a nice understatement.

I share Chairman Clayton's concern. The decline of our public markets is a troubling trend for our country's competitiveness and for American investors and for retirement savings as well. The solution to this crucial problem is to focus on policies that will make companies want to go public and preserve options for raising much-needed capital, all of which will lead to increased competitiveness and more investment opportunities for everyday investors to grow their savings.

I would like to commend the Commission for their efforts to improve capital formation for smaller companies, particularly by re-examining the exempt offering regulatory framework. Many of these exemptions were modified or created by the JOBS Act of 2012, a landmark bipartisan piece of legislation that has had a major impact on capital markets and small businesses.

Now, it is time for the SEC to revisit these private offering exemptions to streamline and improve the regulatory framework to better promote capital formation and grow investment opportunities. One exemption that warrants modernization is the crowdfunding exemption.

My original crowdfunding bill, which was included in the JOBS Act, was only a few pages long, 11 pages, in fact. I appreciate the SEC and their hardworking staff creating 685 pages worth of regulation around those 11 pages. The absurdity of this, I have pointed out a number of times since then, so you have given me at least the rhetorical value of talking about the burden of SEC regulation, making an exemption and a public law completely meaningless because of the impact and the cost.

So, I encourage the SEC to continue its efforts to expand investor access to all companies and to maintain its focus on reducing regulatory barriers that discourage companies from going or staying in our public markets. Stronger public markets translate to more economic growth and greater opportunity for everyday American investors to grow their savings and reach their goals of homeownership, retirement, or simply a better way of life.

In conclusion, we will hear a lot of doom and gloom today. It is not all doom and gloom. The markets now appear healthier in the last 2 years. Investment opportunities are better now than they have been in recent years. I think there is a lot that is praise-

worthy in the SEC's approach and how the market has responded to that.

I look forward to your testimony and the questions today.

Chairwoman WATERS. I now recognize the Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, Mrs. Maloney, for 1 minute.

Mrs. MALONEY. Thank you, Madam Chairwoman, for holding this important hearing and for inviting all five Commissioners. The SEC has been active on issues such as cryptocurrency, market structure, and corporate governance. But by far, the most important action the SEC has taken was in June when they finalized regulation best interest, or Reg BI.

This rule was intended to raise the standard of conduct for brokers and to offer investment advice to retail investors. Unfortunately, I believe the rule was far too weak and did not raise the standard for brokers nearly enough. And to make it worse, the SEC also weakened the fiduciary standard for investment advisers, which was completely unnecessary and goes against the SEC's mission of protecting investors.

So, I will be interested to hear from the Commission about why they chose this path. And I yield back. Thank you.

Chairwoman WATERS. I want to welcome today's distinguished panel from the Securities and Exchange Commission:

Commissioner Robert J. Jackson, Jr., who has served on the Commission since January 2018. Commissioner Jackson came to the Commission from the New York University School of Law.

Commissioner Hester M. Peirce, who has also served on the Commission since January 2018. Prior to joining the Commission, Commissioner Peirce had a post at the Mercatus Center at George Mason University.

Commissioner Elad L. Roisman, who has served on the Commission since September 2018, and prior to joining the Commission, served as Chief Counsel to the U.S. Senate Committee on Banking, Housing, and Urban Affairs.

Commissioner Allison Herren Lee, who has served on the Commission since July 2019. Commissioner Lee has served for over a decade in various roles in the SEC, and most recently has written, lectured, and taught classes on financial regulation and corporate law internationally.

And finally, Chairman Jay Clayton, who has served on the Commission since January 2017. Prior to joining the Commission, Chairman Clayton was a partner at Sullivan & Cromwell and was a member of the firm's management committee.

Welcome, all. Before recognizing you for your testimony, I understand Chairman Clayton has a brief administrative statement. So without objection, Chairman Clayton, you are recognized.

Mr. CLAYTON. Thank you, Chairwoman Waters, Ranking Member McHenry, and members of the committee. Before my fellow Commissioners and I each provide our opening statements, I would like to give our usual disclaimer, which is that each of us will be providing our own views and remarks which do not represent those of the SEC or our fellow Commissioners.

A few other administrative statements: I would like to note that although all five of us are here before you this morning, this is not

a meeting of the Commission under the statute known as the Sunshine Act, and as a result, we plan to be mindful to avoid deliberating on business before the Commission.

We are also sensitive to the potential appearance of prejudgment. This means that although we may offer our views and share our concerns about general issues, we will avoid making a determination during this hearing about the course of action that the Commission should or will take about any particular matter. As with our usual practice, we will keep an open mind and look forward to reviewing a fully developed record before making our determinations.

Also, consistent with longstanding Commission practices, we would not expect to comment on pending litigation or enforcement actions.

Thank you, Chairwoman Waters.

Chairwoman WATERS. Thank you, Chairman Clayton.

For purposes of testimony, each of you will have 5 minutes to summarize your testimony. When you have 1 minute remaining, a yellow light will appear. At that time, I would ask you to wrap up your testimony so we can be respectful of both the witnesses' and the committee members' time.

Commissioner Jackson, you are now recognized for 5 minutes to present your oral testimony.

**STATEMENT OF THE HONORABLE ROBERT J. JACKSON, JR.,  
COMMISSIONER, U.S. SECURITIES AND EXCHANGE COMMISSION**

Mr. JACKSON. Thank you Chairwoman Waters, Ranking Member McHenry, and members of the committee. Thank you very much for the opportunity to join you today. It is my great honor to be joining my colleagues to testify before you on our task at the Securities and Exchange Commission: protecting ordinary American investors.

I want to begin by expressing my gratitude for the special privilege of working with the tremendous SEC staff that we work with every day. I have learned a great deal from them, and everything we do and will discuss today is possible only because of their tremendous public service.

Chairwoman Waters, before I joined the SEC, my work in government as a teacher and as a researcher focused on the gaps in our securities laws that allow corporate insiders to spend shareholder money to advance their own interests rather than those of investors. And because this committee is right now considering legislation that could address some of those gaps, I want to identify three areas where, in my view, doing so would be especially critical for investors.

First, our disclosure rules have not kept up with the pace of today's markets. Specifically, SEC rules give public companies 4 days before they must notify the market about market moving business developments on what is known as our form 8-K.

A study I released before joining the Commission provided evidence that corporate insiders often trade during this gap between key corporate events and when our rules require that event to be revealed to the public. I am grateful that this committee has taken

up bipartisan legislation that would close that gap and give investors the level playing field they so deeply deserve.

Second, our rules incentivize corporate insiders to pursue stock buybacks that maximize executive pay but make no sense for ordinary investors. In a speech last year, I provided evidence that executives engage in significant sales of their company's stock after announcing a buyback. And I expanded upon that work in a letter to Senator Van Hollen this spring showing that when insiders sell into a stock buyback, their company performs worse in the weeks after the buyback occurs. SEC rules should not incentivize buybacks that allow insiders to cash out but don't make long-run sense for ordinary buy-and-hold American investors.

And finally, we should consider giving investors much more transparency into how public companies spend their money on politics. A significant amount of corporate political spending is not disclosed under the law we have today, since public companies can and do give investor money to intermediaries that do not disclose their donors.

Indeed, a study I published in 2013 showed that just 8 intermediaries spent more than \$1.5 billion of investor money on politics over just a short period. Under the law we have right now, ordinary American investors have no way to know whether the companies they own were a source of that money.

Now, that would be less worrying if executives' interests in political spending were aligned with those of shareholders. But when it comes to politics, insiders' interests may diverge from those of investors. Political spending has consequences that go beyond the company's performance, like advancing insiders' preferred political views, and executives' decisions may be influenced by those preferences.

The standard securities laws solution to conflicts like this is disclosure. That is why SEC rules mandate clear disclosure of executive pay. That is why our rules also require companies to give investors detailed information about transactions between insiders and the company. And that is why the case for requiring disclosure of corporate spending on politics is so strong.

Before joining the Commission, I led a bipartisan group of scholars who petitioned the SEC to develop rules requiring disclosure of corporate political spending. Since then, more than 1.2 million Americans have written to the Commission urging us to adopt those rules. And a bipartisan group of former SEC officials, including two former Chairs, have called our proposal a "slam dunk."

But because Congress has used the appropriations process to block the Commission from developing rules in this area, too many American investors today remain in the dark about how public companies spend their money on politics.

I believe that a critical part of the SEC's mission is to make sure that ordinary investors stand on a level playing field in today's markets. Gaps in our securities laws that allow insiders to trade before key information comes to light, stock buybacks that maximize executive pay but not buy-and-hold investor performance, and rules that allow insiders to spend investor money on politics in secret undermine the trust that ordinary Americans have in our financial system.

I am delighted that this committee is considering how best to close those gaps. And, of course, on all of these matters, I remain open to the views of my exceptional colleagues here on the Commission, and it is my great privilege to be a part of their work.

Thank you again for the opportunity to appear before you today. I would be delighted to answer any questions you may have.

Chairwoman WATERS. Thank you, Commissioner Jackson.

Commissioner Peirce, you are now recognized for 5 minutes to present your oral testimony.

**STATEMENT OF THE HONORABLE HESTER M. PEIRCE, COMMISSIONER, U.S. SECURITIES AND EXCHANGE COMMISSION**

Ms. PEIRCE. Chairwoman Waters, Ranking Member McHenry, and members of the committee, it is an honor to be here today, and it is a particular pleasure to be here with my colleagues. We all share a common passion for the capital markets because we believe they have the power to unleash talent all across the country, and that is good for all of us.

Under Chairman Clayton's leadership, and with the help of our hardworking staff, we are applying this shared passion for the potential of the capital markets to change people's lives, to collaborate and think through a wide range of issues related to protecting investors, facilitating capital formation, and protecting the integrity of our markets.

I would like to talk to you today about three principles that I apply when I do my job. The first is that investor protection means more than just protecting investors from fraud. It also means protecting their opportunities. The second is that while enforcement is an important part of our mission, regulation is the key part of what we do. It is our first step, not our last step. And third, we as regulators don't—and we can't—know everything.

Investor protection is, of course, on our minds in everything that we do. One of the key purposes of the securities laws is to make sure that investors get the material information they need to make decisions about where to invest their hard-earned money, and they often do that with the help of a financial professional.

Our Office of Investor Education and Advocacy helps investors navigate the complex financial markets, and through our compliance and enforcement programs we make sure that institutions and individuals involved in our markets are performing their roles in a way that benefits investors in the markets.

Our role is not to make decisions for investors. Investors, if provided with adequate, clear, and truthful information, are best suited to make choices about which investment products serve their own particular needs and goals. When we place unnecessary limits on investors' opportunities to buy products, we risk substituting our own judgment for that of the investors.

Overriding investor preferences about how to spend their hard-earned money is not investor protection. This principle has informed my views on digital assets, retail access to private markets, and retail access to different types of investment financial professionals and investment products. Regulatory flexibility and the attending ability to respond to investor demand are key to making sure that investors get what they want and need.

My second principle is that the SEC is a regulatory agency, not an enforcement agency. Of course, we bring enforcement cases when people flout our rules, as we should, but enforcement is a poor way to announce policy. We need to be clear in writing our rules, and we need to make sure that we provide the guidance that firms and individuals need as necessary. We understand that our rule book is complicated, and we work with well-intentioned firms and individuals to help them comply with our rules.

My third principle is regulatory humility. As I said, we can't and don't know everything. We draw on the talents and expertise of our staff, and we also look outside the building. We have a number of advisory committees that we rely on to advise us on a number of issues. We also hold roundtables with industry and investor representation to talk about pressing issues of the day, and also have investor town halls where we go out and we meet with investors.

We also look to our fellow regulators for their expertise. I, for example, am working on the security-based swap regime trying to get that up and running, and we have been working very closely with the Commodity Futures Trading Commission in making that happen.

We are also looking at our rules all the time to see what needs to change. Sometimes, we need to write a rule to codify exemptive orders that have been issued for a long time, or maybe the staff has been doing something by no-action letter and we are going to adopt a rule to put a more permanent framework in place.

I think regulatory humility comes into play in all of these things. We always need to be asking if we are doing things right. I think one area where I would like us to take a second look, to take a step back and look, is the consolidated audit trail. I just want to ask whether it is right for a government regulator to collect all of the purchase and sale decisions of every retail investor in the United States, regardless of whether they are accused of any wrongdoing.

So with that, I just want to thank you for the chance to be here today. I look forward to your thoughts on what we can be doing better, and I look forward to your questions as well. Thank you.

Chairwoman WATERS. Thank you, Commissioner Peirce.

Commissioner Roisman, you are now recognized for 5 minutes to present your oral testimony.

**STATEMENT OF THE HONORABLE ELAD L. ROISMAN, COMMISSIONER, U.S. SECURITIES AND EXCHANGE COMMISSION**

Mr. ROISMAN. Thank you. Chairwoman Waters, Ranking Member McHenry, and members of the committee, thank you for inviting me to testify today. I am honored to appear before you with my fellow Commissioners. This month marked my 1-year anniversary as a Commissioner, so I will use this opportunity to share some of my reflections on the past year.

I have often said that the U.S. capital markets are the envy of the world, and the importance of the SEC's role cannot be overstated. It is truly a privilege to go to work every day with the dedicated and hardworking staff of the Commission. They embody and deliver on the SEC's tripartite mission: to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

Protecting investors is front of mind for me as I dedicate time each day to reviewing potential enforcement actions as well as potential rules. Our written testimony provides more detail, but I am consistently impressed by the matters the staff presents to the Commission with protecting investors in mind.

I think it is important to note that all of our divisions and offices, not just Enforcement, are working to protect investors. For example, the SEC's Office of Compliance, Inspections, and Examinations has been instrumental in conducting exams in high-risk areas across the industries we regulate.

Not only have I seen them spot and refer potential securities law violations to our Enforcement staff, I have seen them help us get ahead of such violations by directly engaging with the SEC registrants and publishing materials that all compliance professionals can use to do their jobs more effectively.

The Office of Investor Education and Advocacy has also played an important role in protecting investors through their bulletins, videos, and outreach events. I have been particularly impressed at how all of the Commission's divisions and offices work together to address an area that I care deeply about: elder investors.

As one example, next week, staff from across the Commission will host a roundtable on elder investor fraud with experts from the private and public sectors. I look forward to joining the SEC staff at this event and engaging with everyone in how we can better identify, prevent, and combat fraud targeting elder investors.

With regard to maintaining fair, orderly, and efficient markets, I take this part of our mission very seriously. Market integrity is a priority for me, not only with respect to our equities markets but for our fixed-income and Treasuries markets as well. In this area, I greatly appreciate the work that our Division of Trading and Markets has done to closely assess how these markets are working, whether they work as intended, and where there is room for improvement.

Outside the secondary markets, the Division of Investment Management has also done impressive work to streamline and improve regulation of important segments of the asset management industry through which U.S. retail investors are increasingly accessing securities markets.

With regard to the final tenet of our mission, encouraging and facilitating the entrance of companies into our capital markets, especially small businesses, is incredibly important. I appreciate that for the past year, the Division of Corporation Finance has been working hard hosting roundtables, soliciting comments from the public, recommending rules to facilitate issuers' ability to conduct registered public offerings, lower their cost of capital, and provide Main Street investors with more investment opportunities.

I believe their participation is a necessary component of successful capital markets and one that has been the hallmark of our markets since their inception. It is also a reason that countless Americans have been able to save for retirement, pay for school, and deal with unexpected financial inflection points in their lives.

I would also be remiss in not mentioning my interest and appreciation for this Commission's focus on the proxy process, which I believe is a fundamental aspect of our capital markets.

In closing, I am grateful for the opportunity to share with you some highlights from my first year as an SEC Commissioner. Your oversight of our agency helps us operate at our best, and I look forward to answering any questions you may have for me. Thank you.

Chairwoman WATERS. Thank you, Commissioner Roisman.

Commissioner Lee, you are now recognized to present your oral testimony.

**STATEMENT OF THE HONORABLE ALLISON HERREN LEE,  
COMMISSIONER, U.S. SECURITIES AND EXCHANGE COMMISSION**

Ms. LEE. Thank you. Chairwoman Waters, Ranking Member McHenry, and members of the committee, thank you for the opportunity to testify before you today. I am roughly 2 months into my term as a Commissioner at this point, and it has been a privilege to work with my distinguished colleagues here and with the dedicated staff of the SEC.

Having served at the SEC for over 13 years prior to my appointment, I have experienced firsthand and developed a deep appreciation and respect for the commitment and dedication of the staff to the mission of the Commission.

I can say from my vantage point as a Commissioner, that respect has only increased as I have met and worked with dozens of dedicated staffers in each of the divisions, people who have developed extensive expertise through years of day-to-day, hands-on work with investors and other market participants.

I am inspired by their commitment as well as that of my colleagues here today, and I am more determined than ever to do all that I can to help the Commission do its part to protect and strengthen the economic well-being of Americans and American businesses.

Although we deal with a large number of often highly complex issues and rules from market structure to cybersecurity, they should all be viewed and analyzed through this lens of whether and how they will promote and strengthen the economic well-being of everyday Americans saving to buy a home, to send their children to college, and to eventually retire, and American businesses which need a fair marketplace with clear and manageable rules to facilitate growth.

This committee has identified a number of critical issues for discussion today: the increase in the amount of capital raised in private versus public markets; the importance of ensuring that public companies disclose in the most effective manner possible the information that investors need to make informed decisions in an era where business models and the relevant risks to those models are changing; the SEC's enforcement program and its ability to get money out of the pockets of fraudsters and back into the hands of their victims; digital assets and cryptocurrencies; and the role of financial intermediaries in our markets.

With all of these issues, it is important for the SEC to be held accountable by the investing public, by those we regulate, and, of course, by this committee and by Congress. Whether we are making changes to the staff's longstanding review process for shareholder proposals, assessing fiduciary duties of investment advisers

with respect to proxy voting, or considering how best to modernize and strengthen public company disclosures, we must be fair and transparent about the policy choices we make and the data and information on which we rely in making those choices.

I thank the committee for its interest in and oversight of these important issues, and I stand ready to answer your questions and listen carefully to your thoughts and concerns. Thank you.

Chairwoman WATERS. Thank you very much, Commissioner Lee.

Chairman Clayton, you are now recognized to present your oral testimony.

**STATEMENT OF THE HONORABLE JAY CLAYTON, CHAIRMAN,  
U.S. SECURITIES AND EXCHANGE COMMISSION**

Mr. CLAYTON. Thank you, Chairwoman Waters. And I want to echo the thoughts of my colleagues on the opportunity we have to testify today and also just note that their testimony demonstrates the wide range of issues that the Commission deals with every day.

I want to thank this committee for your support of the Commission, and in particular, the dedicated women and men who are our most important asset. The funding that you provided to us for Fiscal Year 2019 allowed us to lift our hiring freeze and make new hires in critical areas including enforcement and examinations, market oversight, cybersecurity, and small business capital formation.

I am pleased to report that we have filled approximately 100 new positions with high-quality individuals that I expect will serve American investors very well. The fiscal 2019 funding that you provided us also allowed us to continue to make significant investments to, and upgrade and otherwise improve, our IT infrastructure, cybersecurity, and risk management. We have made progress in these critical areas. However, our information technology needs and the related risks are ever changing, and let there be no doubt, substantial work remains.

Turning to our mission, for me, the interests of our long-term Main Street investors are front of mind. I believe our 4,300 colleagues share this perspective. I want to highlight just a few examples of the recent work of the Commission in this regard, starting with our Division of Enforcement.

I note our teachers and military servicemembers initiatives, which focus additional enforcement and investor education resources on behalf of teachers, veterans, and Active Duty military personnel. Unfortunately, these hardworking Americans are too often targeted and fall victim to fraud, shady and self-serving practices, and other misconduct.

My message is simple: If you are ripping off teachers, servicemembers, or veterans, we want to catch you, we want to punish you, and we want to get them their money back. Returning funds to harmed investors continues to be a priority for me and the Commission. I previously testified about challenges including legal impediments we face in obtaining funds from bad actors in cases with long-running, well-concealed frauds, such as Ponzi schemes. I want to recognize and thank this committee for its bipartisan work to address these challenges.

Enhancing Main Street investor protection while preserving and improving access to investment opportunities also has been a priority. In June, the Commission adopted a long overdue package of rules and interpretations to require candor and impose other responsibilities on broker-dealers and investment advisers and their dealings with our Main Street investors.

As a result, for the first time, regardless of whether an investor chooses a broker-dealer or an investment investor, the investor will be entitled to a recommendation that is in the investor's best interest and does not place the interests of the firm or the financial professional ahead of the investors.

This strong rulemaking package was informed by the Commission's expertise and decades of experience regulating, inspecting, and bringing enforcement actions in this space. It also benefited from unprecedented direct shareholder engagement, including seven townhall-style investor roundtables held across the country. We are already seeing the benefits of this work.

We are also focused on the implications for Main Street investors of the substantial changes that have taken place in our markets over the past 2 decades. For example, 25 years ago the public markets dominated the private markets in virtually every measure.

Today, the private markets outpace the public markets in many measures. However, in our private markets, Main Street investors: one, typically do not have the same access to investments as sophisticated professional investors; and two, where they do have access, they typically do not have the same alignment of interests with sophisticated professionals as they do in our public markets.

In response, we continue to explore initiatives to increase the attractiveness of our public capital markets as places for companies to raise capital. At the same time, we are also exploring whether we can increase the type and quality of opportunities for Main Street investors in our private markets while maintaining appropriate investor protections, including aligning the interests of Main Street investors with professional investors.

In closing, I want to refer you to our written testimony which details a number of the risks that we are monitoring along with our fellow U.S. regulators and regulators around the globe. Thank you, and I look forward to your questions.

[The joint prepared statement of the SEC can be found on page 68 of the appendix.]

Chairwoman WATERS. Thank you very much, Chairman Clayton.

I am going to deal with two issues here as I recognize myself for 5 minutes for questions. First, I want to deal with insider trading. I am going to you, Commissioner Jackson. Current loopholes in the law allow corporate insiders to enrich themselves at the expense of the shareholders. For example, there is evidence that insiders are misusing SEC rule 10b5-1 to engage in illegal insider trading by changing the trading plans.

My bill, the Promoting Transparent Standards for Corporate Insiders Act, would require the SEC to study this apparent misuse and amend its rules accordingly. This bill passed the House on a broad, bipartisan basis. Can you please discuss why it is important to retail investors and market integrity for loopholes to be fixed?

Do you agree that the Promoting Transparent Standards for Corporate Insiders Act is a common-sense fix to the apparent loophole in rule 10b5-1? Insider trading has been a problem historically. What do you think?

Mr. JACKSON. Thank you, Chairwoman Waters. First of all, I want to thank you and this committee for focusing on this important issue. Rule 10b5-1 was adopted some time ago, and it is always a good practice for us to dig back into our rules and see if they are serving their intended purpose.

That rule was intended to allow insiders to make trading decisions long in advance, not based on any particular timing. And there is some academic evidence to the degree that they are taking advantage of investors. So, I think studying this subject makes a great deal of sense. And, again, without commenting on any particular legislation, I am glad this committee is focused on this issue.

Chairwoman WATERS. Thank you very much.

And now, for Chairman Clayton, as we have discussed, I am extremely concerned about Facebook's planned cryptocurrency, Libra, and digital wallet, Calibra, and their potential impact on investment consumers and the American financial system.

Treasury Secretary Mnuchin, Federal Reserve Chairman Powell, and even President Trump have raised similar concerns. Just this month, regulators from France and Germany both agreed to block Libra from their countries. In a joint statement, the two governments stated that, "No private company can claim monetary power which is inherent to the sovereignty of nations."

Can you please talk about the systemic risk and risk to investors that Libra, as currently described, would pose?

Mr. CLAYTON. Thank you, Madam Chairwoman.

I am not going to comment on any specific crypto asset, other than I will note that the attention that Libra has raised, I think, is a good thing. We are having these discussions and regulators around the world are focused on it.

But I do think that crypto assets, while they have benefits, including eliminating frictions and the like, can present a great deal of risk, particularly in cases where in form they are the same as securities or the same as currencies or the same as payment systems, but they are not regulated in the same way.

We have developed what I would say is an ecosystem of financial regulation over the years—securities, commodities, currencies, payment systems—that deals with a great deal of risk to investors and risk to our markets more generally. To the extent a crypto asset would be used to evade those regulations, I have a real problem with it.

Chairwoman WATERS. What are you doing now to take a look at Libra and Calibra? Have you set up a committee, a commission, an advisory group? Are you looking at it so that you can understand what those risks are?

Mr. CLAYTON. Yes. We have a group at the Commission that is focused on digital assets, both the potential they have to add efficiency but also the risks they pose. And look, we saw this in the "ICO space", \$4 billion—pick your number—raised, most of it gone, not complying with our rules.

I think we had a great effort from our Division of Corporation Finance as well as our Enforcement Division to say, hey, if you are selling securities, you have to follow our rules. And we are going to do the same thing across all digital assets that touch in the securities space.

Chairwoman WATERS. So you do have a committee of some sort that is taking a look at what is happening with the development of Libra?

Mr. CLAYTON. Yes. All digital assets that come to our attention—also, say, at FSOC—we are looking at digital assets in a more—

Chairwoman WATERS. What about the entire blockchain phenomenon? What do you know about that? What work has been done on that? Is there an opportunity to perhaps brief the legislators on the work that you may be doing both looking at Libra and looking at all of blockchain?

Mr. CLAYTON. I would be very happy to do that with my colleagues at the Commission. I can't speak for other Federal financial regulators, but jointly with them, I would be happy to do it.

Chairwoman WATERS. Thank you very much.

I now yield to the gentleman from North Carolina, Ranking Member McHenry.

Mr. MCHENRY. Well, why don't we start there, Chairman Clayton? Why don't we start with digital currencies, those tours are going to end. The chairwoman and I have a similar thought process on raising the question. Based off your current analysis of the Libra project, which is just an idea at this point, a White Paper, Chairman Clayton, do you believe that Libra is a security?

Mr. CLAYTON. I am not prepared to make a decision like that here. We have to see how different assets function to decide whether they would be a security, a commodity, a currency or not. But if what you are doing is using a digital asset to raise capital for a project with the idea that you are going to get a return as a result of investing in that project, that sounds like a security.

Mr. MCHENRY. Okay. But let's acknowledge there is a larger ecosystem to raise money globally outside the U.S. jurisdiction, right?

Mr. CLAYTON. Yes.

Mr. MCHENRY. So we need to have appropriate regulation, but overly onerous regulation just drives off the innovation from the United States and the upside potential for investors. isn't that correct?

Mr. CLAYTON. That is correct.

Mr. MCHENRY. I know, Commissioner Peirce, you have done a significant amount of work in this space. But for cryptocurrencies, we see the Blockstack had their Reg A offering approved. Now, walking through that process, Commissioner Peirce, do you believe we have a pretty solid ecosystem for cryptocurrencies to exist in the United States and to raise capital in a regulated environment?

Ms. PEIRCE. I think we still have work to do to make sure that people can develop digital assets in the U.S. in compliance with our rules. I would like to see us be a little bit more forward-thinking in ways that we might accommodate unique aspects of digital assets.

For example, digital assets that are utility tokens, I don't know that the securities law framework that we have right now is the

appropriate framework for them, and so I would like to see us think about creating some kind of a safe harbor. Again, the idea is to allow—

Mr. MCHENRY. Is there current law for the SEC to write regulations around them?

Ms. PEIRCE. I think we have authority that would enable us to work on something like that. I am still giving it some thought, but I think we do have authority that could allow us to do that.

Mr. MCHENRY. Chairman Clayton, how would you respond?

Mr. CLAYTON. We have a lot of discussions about this. I agree with Commissioner Peirce that, to the extent this technology facilitates capital raising consistent with our investor protection, I think it has been pretty good in the private space.

I would like to have more access for individual investors. If we can use it to have more access in a protected way, I am good with it, and I am good with exploring ways to do that. But what we saw in the ICO space was something that—I don't think anybody thinks that was a success.

Mr. MCHENRY. Okay. So, let's move to crowdfunding. I raised this in my opening statement: 11 pages of legislative text that we passed in a bipartisan way, not without dissenting votes but we had fewer than 15 dissenting votes on the House Floor, and a bipartisan nature.

So, investment crowdfunding, regulation crowdfunding such as the limits on individual investment limits the total amount raised in the overall goal of this, is the SEC willing to reexamine those 685 pages of extensive, onerous regulations?

Mr. CLAYTON. Yes, and I think we should. I think if you look at the markets for small businesses capital formation, regulation crowdfunding shows that you can get started. You can get up to—and I am going to talk about pretty large valuations, but they are small in the range of businesses—a \$1 million company going with reg crowdfunding and some of our other exemptions.

It is really hard to grow a business from, say, a \$1 million business to a \$50 million business because you are talking about individual investors and crowdfunding at \$1 million. You are talking about professional investors at \$50 million. There is kind of a big gap there. Things that we can do to facilitate capital formation in that gap so our small businesses can become larger, I think that is an area we should focus on.

Mr. MCHENRY. Okay. So, to go much more broadly here, Chairman Clayton, we have fewer public listings than we did 20 years ago. That means mom-and-pop retail investors don't have the same potential that they did 20 years ago for their long-term savings. Is this a concern to you, and if so, what are you doing to address it?

Mr. CLAYTON. It is a very big concern of mine. The great thing about our public markets is that mom-and-pop investors invest right alongside, with the same deal as professional investors. I like seeing capital raising in that environment. This group passed the JOBS Act. I think the JOBS Act helped encourage companies to go back into the capital markets. One of the things we have been doing is looking at those JOBS Act provisions and seeing if we can extend them.

Mr. MCHENRY. Thank you.

Chairwoman WATERS. The gentlewoman from New York, Mrs. Maloney, who is also the Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, is recognized for 5 minutes.

Mrs. MALONEY. Thank you, Madam Chairwoman.

Chairman Clayton, as you know, I have long been an advocate for using structured data in financial reporting, and I think it helps both investors and public companies, and it actually makes it easier for companies to raise capital. Last year, the SEC adopted a rule requiring public companies to report certain financial and risk information in so-called Inline XBRL format. And I applaud the SEC for taking this step.

Today, I am going to be introducing a bill with Ranking Member McHenry called the Financial Transparency Act, which would direct financial regulators, including the SEC, to require that companies make their filings in structured data format.

I would like to ask you, Chairman Clayton, in light of the SEC's work in this area, do you think that this bill is a step in the right direction and complements the good efforts of the SEC in this area?

Mr. CLAYTON. To the question of making data more usable, accessible to various market participants, yes, and in particular, doing it in a way that depending on whether you are very sophisticated or a retail investor, you can have access to that data, I am very supportive of that.

I will note that how data gets scraped and used has changed over time, and I would just encourage everyone in this space to be forward-looking and allow flexibility in achieving the objectives of making data more accessible. I am supportive.

Mrs. MALONEY. Thank you.

Commissioner Jackson, I want to ask you about the Commission's recent interpretation of the Advisers Act that was adopted along with regulation best interest. But first, I want to remind my colleagues why we passed so many investor protections in Dodd-Frank in the first place.

We did it because 8 million people lost their jobs, 6 million people lost their homes, and the financial crisis destroyed over \$15 trillion in wealth for middle-class Americans, their pensions, their savings, a devastating effect on our economy and our country.

Given all of this, the very last thing the SEC should be doing is weakening rules that would protect investors against these kinds of losses. But unfortunately, that is exactly what the Commission's interpretation of the Advisers Act would do. It would weaken the longstanding fiduciary standard for investment advisers and increase risk for retail investors.

Commissioner Jackson, I know that you voted against this. You opposed the final interpretation of the Advisers Act. Can you explain why you think the interpretation weakens existing law and poses more risks to investors in our economy?

Mr. JACKSON. Thank you, Congresswoman. Yes, I was unable to join my colleagues in voting for those rules.

I dissented from the entire package, and the reason is very straightforward. My own view is that the law in the United States should be clear that when there is a conflict between an ordinary American investor and their financial adviser, the investor comes

first. I think we should be unambiguous about that in all that we do in our work.

And the rules that we adopted, including the interpretation you just mentioned, had instead a muddled standard that has to do with the balance between the various interests. My own view is that we should make clear to American investors that they come first.

And when I dissented, my office released data showing that Wall Street has been saying in brochures to American investors for years that they would come first. So my own view is that not only was it a mistake for us not to make that clear in the interpretation but also that we upset the prevailing expectations ordinary investors have when they entrust other people with their family's financial future.

Mrs. MALONEY. So, how do we correct this?

Mr. JACKSON. A number of the things that I mentioned in my statement would address this problem. One of them would be to use the authority Congress gave us in Dodd-Frank. There is express authority under section 913(g) that would allow us to set a uniform and strong standard with respect to investment advice in this country.

I continue to think that is an approach that we should give more consideration to, and I look forward to seeing how the package we have adopted plays out in the marketplace and whether we actually need to be much stronger in this area.

Mrs. MALONEY. Thank you very much. And possibly, the SEC should revisit this and come back with the standard that President Obama supported and worked so hard for.

I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Oklahoma, Mr. Lucas, is recognized for 5 minutes.

Mr. LUCAS. Thank you, Madam Chairwoman.

First, Chairman Clayton, I would like to commend you and the Commissioners for the tremendous progress the SEC has made in completing the derivatives rules required by Dodd-Frank. And now, as a final step, the SEC will need to address the cross-border application of these rules.

I guess my first question would be along the lines of, in a transaction that occurs between parties fully outside of the United States, a U.S.-based employee will often help arrange, negotiate, and execute the transactions. And these are referred to as ANE (arrange, negotiate, or execute) transactions.

I have long been an advocate of harmonization between the SEC and the Commodity Futures Trading Commission (CFTC). As such, I would like to urge the SEC to harmonize with the CFTC on how ANE transactions are treated. In this vein, I hope the SEC recognizes the need to safeguard against any incentive for firms to move jobs abroad.

So, Chairman Clayton and Commissioner Peirce, could you speak to the issue of harmonization with the cross-border rule? I would love to hear from you both.

Mr. CLAYTON. I want to thank Commissioner Peirce for taking the lead on these rules. She has done a terrific job, including work-

ing with our colleagues at the CFTC. And you raise one of the difficult issues that we are making. You have a transaction between two parties outside the United States, but let's say it is arranged in the U.S. because that is where the expertise for this transaction is. And, in fact, it may involve what we would consider an asset or a security that is important to the U.S., like U.S. interest rates, or in our case, a U.S. security.

At what point do we say that the risk that is offshore on the parties is something that we still have an interest in regulating because it happens here in the United States? Commissioner Peirce and I are working with our colleagues and our colleagues here on trying to draw that line in a way that makes sense not only for regulating the parties but also dealing with systemic risk.

Ms. PEIRCE. And I would just add that we have been working very closely with the CFTC on this issue as well as other issues in the title 7 space, and I think we can draw from their experience of what has happened in their markets because obviously their regime has been up and running, whereas ours has not. So we are talking with them, we are learning from them, and we are trying to achieve harmonization as well as allow substituted compliance in other areas where that is appropriate.

Mr. LUCAS. Because clearly, we live in a world where both talent and resources are easily moved around the globe. Again, I want to express my appreciation for your work in supporting more efficient markets and serving U.S. investors.

So back again to you, Chairman Clayton, we have spoken several times on your active engagement with the CFTC. Could you elaborate on any other areas in particular where you hope to see further coordination?

Mr. CLAYTON. I think an area where there is, I would say, room for improvement, but we are doing well, is on inspections, as we both inspect some of the same firms and on further harmonization, including on reporting of information. It doesn't make a lot of sense to require people to report two different sets that essentially have the same information. Those are the kinds of things we can improve.

Mr. LUCAS. Thank you, Chairman Clayton.

And amazingly enough, Madam Chairwoman, I yield back the balance of my time.

Chairwoman WATERS. Thank you.

The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. Mr. Jackson, thank you for your presentation, as it is indeed outrageous that shareholder money is used to pursue political objectives that may not only contradict what the shareholder wants but is done in total secrecy so the shareholder doesn't even know how their money is being spent to, in their view, make their country worse.

The Chair talked about cryptocurrency, and I do have a few comments. The U.S. dollar is an extremely good currency, a medium of exchange, a store of value. It fails, however, to meet the needs of tax evaders, terrorists, sanctions evaders, and drug dealers. Hence, there is a market for an alternative based on those four

markets, and the tax evader market is the giant share of that market.

The SEC is going to have to construe laws, and one principle of construing laws is to do so in the public interest. It is not in the public interest for you to facilitate the creation of a device chiefly used by tax evaders, terrorists, and sanctions evaders.

It is pretty clear that the Libra will be a mutual fund. Mark Zuckerberg has a lot of money, but he doesn't have the power to print more. He will have that power if Libra fulfills all of its expectations. It will be called Libra by them. I call it the "Zuck Buck" from Mr. Zuckerberg.

Please do what you can to stop this. It meets no need for anyone who wants to follow our laws. And if you read the statements of those who want to disempower the Federal Government, they are thrilled with cryptocurrency in each of its developments.

Now, a small business investor alliance—a small business investment company question. This Congress last year in a House report said that exempting business development companies (BDCs) from being covered by the AFFE (application of acquired fund fees and expenses) rule dealing with expense reporting, given their similarities to operating companies, which are not covered by that rule, and the special role as capital providers for small business, will result in positive results for managers improving corporate governance and transparency.

So I would hope there was a positive development when you issued your proposed fund-of-funds rule. I hope that you would take steps so that BDCs can once again be portfolio investments of mutual funds and get the kind of analysis by analysts who are doing the work which will then benefit private investors as well.

Chairman Clayton, any comment on BDCs?

Mr. CLAYTON. I think you framed it well as part of our fund-of-funds proposal. There is the tension there. Is it multiple layers of fees, or is it closer to an operating company? I think we are—I want to commend our staff for the thorough way that they are looking at this.

Mr. SHERMAN. I think it is closer to an operating company. But it is not just me; that is a House report.

Mr. CLAYTON. I understand, and I just wanted to frame the issue.

Mr. SHERMAN. Speaking of CECL (current expected credit losses), our Constitution calls for government power to be exercised by those who are elected. FASB exercises government power, but not only are they not elected, they are not even government employees. They derive their power from you.

I talked to Mr. Russman at my office, and he was of the view that perhaps you shouldn't exercise any oversight over FASB's substantive decisions. That would be a constitutional travesty to think that you could go to jail for violating a rule promulgated by someone who isn't even a government employee or elected official, and that that rule has not even been substantively reviewed by anybody who is.

But worse than a Constitutional travesty, it is an accounting theory travesty. It is a terrible proposal, and its only defense is that its adoption will cause banks to have higher reserves than the

bank regulators think they want to impose. And I would say, please do not use your power to delegate power to some folks up in Norwalk to impose bank regulation that they think is appropriate when we have already established bank regulators.

I have a lot of questions for the record, and I yield back.

Chairwoman WATERS. Thank you very much.

The gentleman from Florida, Mr. Posey, is recognized for 5 minutes.

Mr. POSEY. Thank you very much, Madam Chairwoman. I appreciate your and the ranking member's leadership in holding this hearing.

The work of the Securities and Exchange Commission is important to protecting investors. And I also want to thank each and every one of you for appearing today.

It has been nearly 10 years since Allen Stanford was arrested for running the second-largest Ponzi scheme in the history of the United States, and the collapse of the Stanford Financial Group. Over 21,000 victims of Mr. Stanford's crimes, mostly hardworking middle-class Americans, some of whom reside in my district, have yet to be repaid in any meaningful way at all. The Stanford victims have received approximately 4.5 cents on the dollar, while the seemingly more influential or well-connected victims of the Madoff Ponzi scheme have received 75 cents on the dollar recovery.

This result is really difficult for the public and for me, quite frankly, to understand, and obviously, it is not acceptable.

Of the more than \$5 billion in losses, the court-appointed receiver has recovered just \$750 million. But what is more appalling than that is that nearly 50 percent has gone into the pocket of the receiver.

As if it couldn't get any worse, the receiver recently used his authority to bar individual investor claims against the banks which potentially aided and abetted the Stanford fraud.

In fact, one of my constituents, Annalisa Mendez, and a dozen other victims recently wrote to the receiver and asked them if they might consider changing their course, to which the receiver did not even give them the courtesy of a reply.

So, I would like each of you to express to me or respond to the question of whether or not you think it is appropriate to bar investor claims in a case that has returned investors only 4.5 cents on the dollar in 10 years. We can start with Mr. Roisman and go right down the line.

Mr. ROISMAN. Thank you for bringing this topic up. Obviously, travesty is the right word.

I think if there is a means for collecting for wrongdoing, we need to ensure that is something that people can count on to collect. If we don't have an adequate system, it creates questions and shakes our confidence not only in the financial services industry, but the oversight of it.

Mr. POSEY. Commissioner Peirce?

Ms. PEIRCE. I am happy to look into that issue. I am not familiar specifically with the issue of the receiver barring investors from pursuing claims against banks, but I am happy to look into it and get back to you.

Mr. POSEY. Thank you.

Chairman Clayton?

Mr. CLAYTON. I will try to be brief, to give my colleagues time. But I have actually spent a lot of time on this. I have met with the victims, the victim groups. I went down and met with the receiver and the examiner about 10 days ago. This is not an acceptable result at all.

With respect to your specific question about the bar, there is a judgment to be made there. Minds can differ. I am aware of the issue, and we are continuing to look at it. But rest assured, I have been fully briefed on this issue.

Mr. POSEY. Do I have the understanding that you are going to do more than observe it? Do you plan any engagement? Do you foresee any engagement? Do you foresee the cavalry coming to help the victims?

Mr. CLAYTON. Let me say this: I am looking for any opportunity to help the victims get more money back faster.

Mr. POSEY. Okay. We will have another question about possible solutions you can be thinking about in the meantime.

Commissioner Jackson?

Mr. JACKSON. Congressman, thank you for bringing this to our attention. I think Commissioner Roisman put it just right; this is a travesty. And like Commissioner Peirce, I would be happy to look into this more deeply.

Of all the things you have said, sir, what is most troubling is that you have a constituent who didn't get a response. And any American investor who has been involved with this situation is entitled to that. So, I am happy to look into that further, sir.

Mr. POSEY. Thank you.

Commissioner Lee?

Ms. LEE. Yes, I agree. And I will say that in my experience as an enforcement attorney, I have seen firsthand the damage that is done to victims such as your constituents, and I find it extremely troubling. So, I wholeheartedly support any effort we can make to return more money to those investors and I will work with my colleagues to do so.

Mr. POSEY. Okay. My time is about to expire, so I won't get to ask the other questions.

But I would appreciate it if you would let my office know of possible solutions you have online or might be able to come up with or anything that you think Congress could do to empower you more to do something about this.

My time is up. I yield back. Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you very much.

The gentleman from New York, Mr. Meeks, who is also the Chair of our Subcommittee on Consumer Protection and Financial Institutions, is recognized for 5 minutes.

Mr. MEEKS. Thank you, Madam Chairwoman.

I have a few issues that I want to discuss. One thing that I am concerned about is the growing practice of activist hedge funds attacking closed-end funds. These proxy contests and related lawsuits by activist hedge funds are not about improving governance, but rather about coercing closed-end funds that cannot adequately protect themselves. These hedge funds are evading the 3-percent limit

specified in the 1940 Act through the use of multiple intermediaries which they control.

This causes the closed-end funds to be either liquidated or severely impaired for short-term profits. The losers, thereby, are the mom-and-pop retail investors.

So, Commissioner Jackson, would you agree that this practice is: one, illegal; and two, what is the SEC doing to curtail these activities?

Mr. JACKSON. Thank you, Congressman.

Without commenting on any particular practice, here is what I want to say. I share your concern, sir. And, in fact, one of the things that is most troubling about this is that closed-end funds ordinarily are held by retail investors, ordinary buy-and-hold, mom-and-pop investors who bought the fund on the understanding that it wouldn't be attacked in just this way.

In this area, sir, I am guided by the evidence. I helped to write a paper a few years ago to show that when takeover defenses were called into question by the SEC some time ago, it hurt ordinary investors. This actually hurt the value of closed-end funds.

So I am committed to working on this subject, sir, and I look forward to working with my colleagues on the Commission to make sure that those ordinary mom-and-pop investors and closed-end funds are protected.

Mr. MEEKS. Thank you.

Let me move to the next issue, which was just last week—and I address this is to Commissioner Clayton—interest rates in the repo market skyrocketed, causing the Federal Reserve to announce it would inject around \$400 billion into the market.

In 2010, the SEC proposed a short-term borrowing rule in response to Lehman's lack of disclosure in its repo liabilities. The SEC's proposal stated that a critical component of a company's liquidity and capital resources is often its access to short-term borrowings for working capital to fund its operation. If this rule had been finalized, investors and the public would have much greater information about the obscure repo market.

So, Chairman Clayton, given the concerning market fluctuations of the past few weeks, don't you believe the SEC should finalize a repo disclosure rule?

Mr. CLAYTON. Thank you for that question. I agree that understanding liquidity needs is—well, let's put it this way, it is essential to good oversight, understanding the liquidity needs of our market participants.

The rule that was proposed, in the time since it was proposed, there have been a number of developments, including disclosure requirements by our other Federal regulators and at the SEC in accounting rules. And, in fact, just the other day, we put out Revised Guide 3, which addresses some of these issues.

But you are right to raise the question as to whether we have sufficient insight into liquidity in the repo market, something that we and our other Federal regulators should be looking at. But what I can say is many of the issues that were to be addressed in that proposal have been addressed in other ways.

Mr. MEEKS. Should we be nervous about the economy, of this going over, leveraging over, so that it has an effect? Because we

don't ever want to go back to what took place in 2007. And recently, in an article that came out last week—I know there are a number of financial newspapers, et cetera, that have raised some concerns about where we are.

Mr. CLAYTON. Liquidity is the lifeblood of modern economies, credit-based economies, which is what we have, and we should always be mindful of whether there is sufficient liquidity in our important markets, including our overnight markets. So, yes.

Mr. MEEKS. Let me ask another question in another area in the little time that I have left.

The SEC has a voluntary diversity disclosure assessment program, but there is a response rate of only about 5 percent. I have a bill that would make such disclosures mandatory.

In the meantime, what can the SEC do to ensure companies are releasing this important information to investors and the public?

Mr. CLAYTON. I think it was decided in 2015 that that—I will call it the survey—would be done on a voluntary basis. I have met with our OMWI (Office of Minority and Women Inclusion) Director, Pam Gibbs, on several occasions to try and facilitate greater responses. I think the 5-percent response rate is number of firms, but not number of employees covered. I don't have the exact number of employees. But Pam Gibbs and I are working to try and improve those numbers.

Chairwoman WATERS. Thank you.

The gentleman from Missouri, Mr. Luetkemeyer, is recognized for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Chairman Clayton, I want to follow up on something that Congressman Sherman was discussing a minute ago with regards to CECL. His conversation dealt with Mr. Roisman, and I know I have written a letter to you with regards to the SEC asking for a delay and study of CECL, whether it is appropriate or not, and you, in your letter, stated that the SEC's mission does not typically involve macro-level studies on the impact of accounting standards on financial markets and the U.S. economy, and that this is an endeavor best pursued by the relevant Federal financial regulators.

As an aside, they all seem to think that nobody should be doing this. Everybody is pointing in the other direction here, and nobody wants to do anything. I get the "regulator two-step."

But for the moment, let's say I agree with you that the SEC does not typically do macroeconomic studies. You are a member of the Financial Stability Oversight Council (FSOC), are you not? As a member of FSOC, have you requested that the Office of Financial Research do a study?

Mr. CLAYTON. I have not.

Mr. LUETKEMEYER. That is their job. Why have you not done that?

Mr. CLAYTON. The question—let's take a step back.

I agree with you that if something is going to have an adverse impact—if we are going to choose a measure and then people are going to manage to that measure for a nonprudential reason and it is going to have an adverse effect on our economy, we should be rethinking that measure.

I think in the area of CECL, what we have seen is FASB say, for a number of entities that this would apply to, maybe we should take a step back and evaluate its initial implementation. I think that has been a wise step.

Mr. LUETKEMEYER. Well, if you were proposing this rule, would you do a study?

Mr. CLAYTON. If we were—

Mr. LUETKEMEYER. Yes. Mr. Jackson, a minute ago, talked about how he required data to make a decision to come up with whether he was going to support something. I assume you would do the same thing, would you not?

Mr. CLAYTON. Generally, in our rulemaking, we do economic analysis.

Mr. LUETKEMEYER. If somebody brought to you a problem, I am sure you would ask them, document the problem, show us the data on why you believe it is a problem and why we should address it. Would you not look for the data there to support their assertion?

Mr. CLAYTON. In most cases, yes. Yes, I am very interested in relevant data. This one is, you know, report how you are doing, report how you are managing it.

You and I have discussed this. I think you have a very valid point here, which is we are trying to provide insight into loan losses, or at least, what the standard is. And the question is, in providing that insight, are you changing behavior when that should be done by some other entity?

Mr. LUETKEMEYER. Let's analyze that for a moment. The Financial Accounting Standards Board (FASB) says the reason they are doing this is to have better transparency on the balance sheet with regards to the risk of home loan mortgages on the balance sheet.

The problem with that, as investors have been telling me, is it is supposed to be for the investors. If the investors are telling me, look, instead of a uniform model across all of the institutions that reserve exactly the same, now we have a different model for every single institution. So now, it is more confusing and more difficult to look at than it ever was before.

So this is going to confuse and make the issue more difficult to actually assess risk than it is going to be helpful. And I think a study would also show this.

I guess my question to you is, as a member of FSOC, would you be willing to go to the Board and request that the Office of Financial Research do a study to see if this is something that we need to take a look at?

Mr. CLAYTON. I am not going to commit to that specific course of action. But what I will commit to do is to continue to discuss this with my fellow FSOC members, raising exactly the points you have raised.

Mr. LUETKEMEYER. Well, Mr. Chairman, I am going to give you an example I gave to some of the other regulators.

We just celebrated the 50th anniversary of a man on the Moon. How would you like to be in a lunar module on top of a rocket, knowing that the previous rocket, i.e., mark-to-market, which did not have any study or any cost-benefit analysis on it, in other words, the rocket wasn't tested and blew up on the launch pad. Now, you are sitting on the launch pad with another rocket, i.e.,

CECL, which has not been tested, i.e., a study or a cost-benefit analysis. Are you ready to light that rascal?

Mr. CLAYTON. I would not want to be on that rocket.

Mr. LUETKEMEYER. Thank you very much. That is exactly the answer I get from every single regulator when I give that example.

So, I think it is time we stop and study. I am not asking to do away with the rule. I am asking to see the impact of this. This is going to be, in my view, ginormous, the impact it is going to have on this economy. And to not do our oversight job here, which is to make sure this is going to be something that is going to be helpful, rather than hurtful, is, I think, dropping the ball. My last comment.

Mr. CLAYTON. I will continue to engage on this. I think that the points you are making are ones that we should think about.

Mr. LUETKEMEYER. Okay. I hope you are able to go to FSOC and request a study.

Thank you very much. I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Missouri, Mr. Clay, who is also the Chair of our Subcommittee on Housing, Community Development, and Insurance, is recognized for 5 minutes.

Mr. CLAY. Thank you, Madam Chairwoman.

And I thank the witnesses for your participation today.

Commissioner Jackson, the use of the practice of stock buybacks skyrocketed after the enactment of President Trump's Tax Cuts and Jobs Act. The tax bill provided significant tax benefits to large corporations, such as a lower corporate tax rate and an incentive to repatriate offshore cash, and according to one study led to a 64-percent increase in stock repurchases while real wages for workers remain flat.

Indeed, analysts estimate that in 2018, corporations used nearly 60 percent of their corporate tax cut to repurchase stock. In other words, at a time when wages for average workers have failed to keep up with inflation, corporations have used the corporate tax break to collectively pay \$1 trillion to executive boards of directors and large shareholders, seemingly at the expense of small investors. Instead, firms could dedicate this capital to worker wages, training, hiring, and other investments necessary for innovation and growth.

What is your view of stock buybacks? And should they be curtailed when used in a way that contravenes public policy?

Mr. JACKSON. Thank you, Congressman. I want to make two points in response to all that you have said.

First, I released research earlier this spring and last year to show that our rules right now allow executives to use a buyback as an opportunity to cash out their personal shares.

And, sir, if I were an ordinary buy-and-hold investor, I would be confused that the company thinks the stock is cheap enough to buy, but the CEO would like to sell it. And for me, that raises a real conflict of interest problem that deserves more attention by corporations and by regulators.

But, second, sir, I will say you are right, the use of buybacks has skyrocketed, and we haven't looked at those rules in well over a decade. I think it is time for us to dig into those rules and see

whether they are protecting investors, and that is why I have called for an open comment period for us to review those buyback rules.

Mr. CLAY. Wow. You lay out an analogy that is really troubling, when you think about it. Is the confidence going to be there by those smaller investors? Interesting.

Commissioner Clayton, many pension funds, including some in the State of Missouri, invest in private equity. Can the taxpayers and retired workers in my State be assured that there is adequate oversight of private equity by the SEC?

Mr. CLAYTON. I think what people should understand is that our oversight of the private markets, including private equity, is not the same as our oversight of the public markets. It is one of the reasons why it bothers me that more growth capital is being raised in the private markets.

But to your specific question, we do inspect and regulate that market, albeit in a different way. I was talking to our head of inspections recently about this, we were talking to him. And it continues to be a focus, particularly in the area of disclosure of fees. But yes, we do regulate it, but not to the same extent as we do the public markets.

Mr. CLAY. Can retirees and taxpayers be confident that those investments are protected and that there will be a dollar-for-dollar retirement for people who depend on those retirements?

Mr. CLAYTON. What I am going to say here is, I think if you look over a 20-year period, for money managers who have had a mix of private equity, and public equities, that has been a fairly standard and successful way to do it.

If I am looking out over the range of investment options as a professional investor, and I am seeing that a greater percentage of capital is being raised in our private markets, I have to think I have to allocate—at least think about allocating some money to that. So, we need to be cognizant of that in the way we look at regulation.

I am not going to substitute my judgment for the judgment of a money manager, but looking on a macro basis, if I were in that position, I would be looking at that as an asset class worthy of consideration.

Mr. CLAY. I see.

I thank you both for your responses.

And I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Kentucky, Mr. Barr, is recognized for 5 minutes.

Mr. BARR. Thank you, Madam Chairwoman.

Chairman Clayton, business development companies are an important source of financing for small and mid-sized businesses in my State, having invested almost \$300 million in Kentucky. I don't need an extensive response on this, but I do want to express my support for rationalizing how BDCs are treated under the acquired fund fees and expenses rule. I understand that the SEC staff is presently considering this issue, and I am interested in a favorable resolution, because BDCs have been so important to financing in Kentucky businesses.

I do want to ask you a question about leveraged lending, because of the attention that it has received recently and the alarm about rising corporate debt.

Private credit fund managers, CLO managers, and other nonbank lenders often misregister as investment advisers with the SEC. This results in substantial reporting requirements, regular SEC examinations, and activity limitations.

Some members of this committee have voiced concerns about financial stability with respect to leveraged lending and other nonbank lending activity. In my view, these concerns fail to take into account the role that the SEC plays in overseeing participants in this market.

Chairman Clayton, as a regulator of private credit funds, can you discuss how your agency oversees their activities and how you are sharing this information with prudential regulators?

Mr. CLAYTON. I am going to do this on a little bit broader basis. But what we should recognize is that our economy has grown since—let's just pick a date—2010. It is a credit-based economy. But the amount of credit that is provided directly from the banking sector has gotten relatively smaller. That means the nonbanking sector has to have gotten larger by kind of simple math. We recognize that. We are discussing that with our colleagues at the Fed, the FDIC, the OCC, and others.

But that is the reality. More of the credit that is underpinning our economy is outside of the banking sector and in the private sector, including in funds.

Mr. BARR. Given your oversight over investment advisers, though, do you see a systemic issue at this point?

Mr. CLAYTON. If I saw a systemic issue, I would be doing something about it.

Mr. BARR. So, the answer is no?

Mr. CLAYTON. The answer is no.

Mr. BARR. Okay. Let me move to on Commissioner Peirce.

Commissioner Peirce, as you know, the Business Roundtable (BRT) recently published a revised statement of purpose. Despite some BRT leaders' insistence that it is merely a restatement of existing practices, some on this committee, as would have been predicted, have interpreted this as a shift away from the bedrock principle that directors and officers of a corporation owe an undivided fiduciary duty to maximize shareholder value.

In other words, the primary job of a corporation is not to engage in social engineering, it is not to engage in politically correct causes; it is to maximize shareholder value.

That is not to say that a company's social concerns, environmental considerations, or activities to ensure the well-being of employees, suppliers, or customers are irrelevant. It just means that shareholders may very well care about those issues and that the market may dictate that they help drive profitability.

Commissioner Peirce, can companies effectively serve their customers, employers, suppliers, and communities without an undivided focus on maximizing shareholder value?

Ms. PEIRCE. I think the singular focus on maximizing shareholder value is very important. It holds managers—it disciplines managers and forces them to focus. And obviously, as they are ful-

filling that mandate, they are going to think about the communities they work in, they are going to think about their employees, and they will think about suppliers as well. So, the focus is really important.

Mr. BARR. The ancillary goals, like those set forth in the BRT statement of purpose, aren't those ancillary goals, those secondary goals predicated on a business delivering a profit and maximizing shareholder value?

Ms. PEIRCE. Yes. This is how companies have always run. They have wanted to serve their customers well so that they can serve their shareholders well.

Mr. BARR. Chairman Clayton, when asked about environmental, social, and governance (ESG) metrics investing in an interview last week at the Delivering Alpha Conference, you noted that lumping "E," "S," and "G" together is difficult because they are quite different.

And, Commissioner Peirce, you have described ESG as scarlet letters that stand for, "enabling shareholder graft."

Shouldn't the central focus of SEC disclosures be to provide material information to the investing public?

And, Chairman Clayton, can you discuss what the Commission is doing to ensure that materiality remains the touchstone of our markets?

Mr. CLAYTON. Well, I very much believe that materiality should be the touchstone of our markets. And as our markets change, what may be material does change, which is why we need to have a principles-based approach to disclosure.

Mr. BARR. Thank you. I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Georgia, Mr. Scott, is recognized for 5 minutes.

Mr. SCOTT. Thank you very much, Madam Chairwoman.

Chairman Clayton, let me ask you this. I want to talk to you about the LIBOR (London Interbank Offered Rate) transition, which is very critical for our financial system, as you know.

The banks who are submitting the reporting information used to determine the LIBOR rate will no longer be compelled to use that in 2021. This is very critical. It is the benchmark that is underlying \$400 trillion in contracts globally and \$200 trillion in contracts right here in the United States.

What impact will this have on our financial system?

Mr. CLAYTON. It is good that you raised this. This is an issue that requires attention. Shifting from LIBOR to an alternative rate, and one of the rates that has been proposed is SOFR (Secured Overnight Financing Rate), there is going to be some friction, because one is sort of a bank rate or one is a secure funding rate.

We need to reduce those frictions as much as possible. There are a number of ways to do it, but the numbers you cite are exactly right. If we are talking about \$200 trillion outstanding now or \$40 trillion that is going to survive the date that LIBOR is scheduled to go away, even small frictions create big numbers.

Mr. SCOTT. Okay. You raised an interesting point, because one of the very critical issues we are faced with now is the need for fi-

nancial education. It is very critical. We have 58 to 60 million unbanked and underbanked folks.

And here is my point. I grew up in a little town in New York called Scarsdale, New York, and when I was in the sixth grade, our sixth grade project at Fox Meadow Elementary School was for us kids to go out, earn our own money, and do the research. And then as a class, we went down to the New York Stock Exchange and bought stock.

That was so profound in my life. It was pivotal. And it led me to being able to buy stock every year. I used that to start my own business, made it up to the Wharton School of Finance, and they put me on the executive board of directors.

And you know what? With John Sculley, who was chairman of Apple, and he was chairman of our committee, and we would go across this country into African-American communities building wealth. And the number one tool we used was investing in the stock market.

Now, do you know that there are less than 17 State school board associations who require the teaching of financial education? That is so critical.

So I want to ask you, nobody can come out and be as strong and be an advocate for financial education being mandatory in our schools. It could start in junior high school before the kids get—and many don't even know about a checking account. And who are they left with? The predators, the people out there.

So tell me, are you all as serious about this issue as we are? We on this committee are making that a priority. Chairwoman Waters, Congresswoman Beatty, and all of us are dealing with this issue. We just passed a bill to mandate the Consumer Financial Protection agency, consumers affairs, to start moving on this.

Can you help us? Can we start a national movement to mandate the teaching of financial education in our schools? I would love for it to start at the sixth grade.

Thank you. What are your thoughts on that?

Mr. CLAYTON. I try very carefully to stay in my lane, Department of Education, SEC. I could not agree with you more about the importance of financial literacy and financial education in our country.

It is not just for investing. It is for opportunities. If you don't have the vocabulary and the tools to participate in our credit-based economy, your opportunities are limited. End of story.

Mr. SCOTT. All right.

Now, I wanted to ask you, Ms. Peirce, about financial fintech harmonization. Chairwoman Waters and I are working on a bill for that. And you gave a speech in Singapore on that.

Could you tell us, what is the state right now of regulatory affairs with fintechs?

Could I ask?

Chairwoman WATERS. You may give the gentleman the courtesy of a short response.

Mr. SCOTT. You are so kind. Thank you.

Ms. PEIRCE. I think we have to take into account that there is a lot of activity happening outside of the United States, and I

would like to try to bring more regulatory clarity in the U.S. so that fintech development and innovation can happen here.

Chairwoman WATERS. Thank you very much.

Mr. SCOTT. Thank you, Madam Chairwoman.

Chairwoman WATERS. You are welcome.

The gentleman from Colorado, Mr. Tipton, is recognized for 5 minutes.

Mr. TIPTON. Thank you, Madam Chairwoman.

And I appreciate you all taking the time to be here today.

Chairman Clayton, I would like to associate myself with the comments of Mr. Luetkemeyer in regards to CECL, to be able to pick that ball up and to carry it. Talking to a lot of our banks, a lot of folks in our district, this is an important issue.

And I think that while the intent wasn't, I am sure, to do harm, it has the potential. It actually impacts us back at home in some of our economies. And I think, as Mr. Jackson noted, being able to do the studies is something that is incumbent on us to be able to follow through on. I did want to make that comment.

And I did want to note that I was pleased to see this year that you had established the Office of the Advocate for Small Business Capital Formation. And would you maybe expound a little bit on what that office is doing and what you hope it might do for the Commission, going forward?

Mr. CLAYTON. Actually, thank you for the opportunity to do that, because I think this office is a very important office for the Commission, but also for our economy.

Capital formation in the small business area, we all know that it is important. Are there regulatory impediments that we can lift without jeopardizing investor protection? That is kind of one of the things we are focused on. That is the nuts and bolts of what we do.

Another thing that we are focused on is, what are the elements of an environment that drives small business capital formation? You see pockets of entrepreneurship around the country. We all know about Silicon Valley, Route 128, Austin is coming on, Nashville—I don't want to leave anybody out. But what are the elements that exist in those places and how can we replicate them in different parts of the country, particularly in the middle of the country? Entrepreneurship is relatively anemic in the middle of the country compared to the coasts, and we want to do something about that.

Mr. TIPTON. I appreciate that, particularly looking into the segments that you are mentioning.

One area, I, along with some of my colleagues through the Small Business Caucus, have been dealing with is in terms of lending to women-owned businesses. There is a huge gap in terms of the lack of participation, if you will, in terms of loaning to women-owned businesses. Are there some areas where you are seeing the opportunity to be able to expand and to encourage that?

Mr. CLAYTON. I agree that is an area we should focus on.

Mr. TIPTON. Okay. Commissioner Peirce, you made some comments, and I think that it falls in line with the Chairman's comments, in terms of looking at some of the regulations that we have

in place, are they a burden or not? You were talking about some of the data collection in your opening statement.

Do you see the opportunity—we all want to be able to have the guardrails in place to make sure that the economy is moving, that we know the rules of the road. But can we get to that burdensome point if we are inhibiting the ability to be able to invest dollars, to be able to raise capital? Can you expand on that just a little bit more?

Ms. PEIRCE. I think the Chairman and his Director of Corporation Finance, Bill Hinman, have really been taking a very close look to see where we can get rid of duplicative requirements and we can streamline existing requirements. The Chairman mentioned trying to focus more on principles-based requirements that are more—they last better over time because they change with the different reality that companies are facing.

Things like that can seem small, but they can make a huge difference for companies that are engaged in trying to raise capital here in the United States.

Mr. TIPTON. Okay. Thanks.

Chairman Clayton, with States like California coming out with extensive privacy laws, has the SEC considered developing additional rules and regulations in the areas within the Commission's jurisdiction to make sure that Americans, regardless of the State that they live in, understand what can and can't be done with their data?

Mr. CLAYTON. I can't tell you that we have had a specific focus on data privacy—I think what you are talking about is a data privacy disclosure for, say, broker-dealers, registered investment advisers dealing with their customers. We have not taken up that initiative specifically.

I understand the issue you are talking about is what kind of disclosure. I think that is also in the consumer space. But you make a good point.

Mr. TIPTON. Okay. Thank you.

And I yield back, Madam Chairwoman.

Chairwoman WATERS. The gentleman from Texas, Mr. Green, who is also the Chair of our Subcommittee on Oversight and Investigations, is recognized for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman.

Mr. Chairman, is it fair to say that we have two products that we are dealing with, the Libra coin being one and the Libra investment token being another?

Mr. CLAYTON. Again, I don't generally talk about specific products or assets. But as I understand your question, it sounds like they are two different products.

Mr. GREEN. All right. Thank you.

And is it true that, in your opinion, if the coin does not produce a return on investment, it is not subject to security regulation, SEC regulation?

Mr. CLAYTON. Again, I am going to step back and talk about assets generally, crypto assets.

A statement such as, "If it doesn't produce a return, it is not a security," I think is a bit of oversimplification.

Mr. GREEN. May I ask this? Generally speaking, let's not have it be a cryptocurrency, but if a product does not produce a return on investment, is it something that you regulate?

Mr. CLAYTON. If what you are saying by a return on an investment, is it—does it give you rights in an enterprise, or is it somehow packaged as a product that is designed to give you a return on your investment, those are the types of things that are securities.

Mr. GREEN. I understand. I use that terminology because you used it earlier when you were giving your statement.

Mr. CLAYTON. Yes.

Mr. GREEN. Okay. Let me just walk through something, if I may, because this is, I think, worthy of consideration.

As proposed, Libra will be backed by the Libra Reserve. And the reserve will be managed by the Libra Association. The association will have members. The members of the association will invest some \$10 million into something called the token, the Libra token. The token investors will receive dividends generated by the yield of the assets held in the reserve. I am sure you are familiar with this because of the position you hold.

If all of this comes together, it seems that we have integrated the token into the coin in some way such as to produce a return, which would then deem it to be a security.

Not specific to Libra and the token, the coin and the token, but generally speaking, would that kind of transaction make it a security?

Mr. CLAYTON. I want to commend you on your understanding of the securities laws and the question you asked, because it is quite a sophisticated question that I believe a lot of lawyers have probably spent a lot of time trying to find out where that line is, whether there is a sufficient amount of integration to cause something that would be a store of value to become—just a simple store of value to become a security.

I am not going to, in this forum, make a judgment on whether something is a security or not, particularly when we can't see how it is used. But you have articulated very well the kinds of issues that we are going to be looking at when we look at assets of this type.

Mr. GREEN. Well, thank you. I will write a letter giving you my opinions, if I may.

Mr. CLAYTON. Please do.

Mr. GREEN. Mr. Jackson, if I may, pursuant to an SEC rule that was finalized on June 5, 2019, Reg BI, are investment advisers true fiduciaries?

Mr. JACKSON. Thank you, Congressman.

My concern, as I mentioned in my—I dissented from that, from the adoption of that rule, sir, and the reason is exactly as you suggested, that my view is that ordinary investors have the following understanding: When someone is a fiduciary to me, they have to put my interests first. And my own view is that the rule we adopted was not clear enough about that. For that reason, I dissented from the package you just described.

Mr. GREEN. Well, I understand this is your position.

Let me ask the Chairman, if I may. I am not trying to put you at odds with each other. I am trying to get a better understanding. Is it your position that they are not true fiduciaries?

Mr. CLAYTON. Here is the thing about a question like that. The term "fiduciary" means a lot of different things in a lot of different contexts.

Mr. GREEN. Well, will they put my interests ahead of theirs, if I am the investor?

Mr. CLAYTON. In both the investment adviser space and the broker-dealer space, the professional can't put their interests ahead of the client's. And for the first time, we have made that clear. If you are an investment professional, you can't put your interests ahead of your client's.

Mr. GREEN. Thank you, Madam Chairwoman. My time has expired.

Chairwoman WATERS. Thank you.

The gentleman from Arkansas, Mr. Hill, is recognized for 5 minutes.

Mr. HILL. Thank you, Chairwoman Waters. Thanks for having this hearing.

And I want to thank the witnesses for being here. What a treat to have the full Commission before the committee. And I certainly want to thank all of you for the public service you are doing and continuing in the 85-year tradition of the SEC of protecting investors and maintaining a remarkable capital formation across all of our markets.

It has been a very interesting discussion this morning. I want to just tick down, as my friend from Colorado did, a few things of interest.

I, too, want to associate myself with Mr. Sherman and Mr. Luetkemeyer on demonstrating leadership in the regulatory system about FASB proposals, when they didn't even follow FASB's own rules under their pronouncements on how to bring that rule forward. So, thank you for that discussion.

I, too, have constituents who suffered mightily at the hands of Sir Allen and the Stanford Ponzi scheme. That led me last week to support the *Kokesh* clarification that came before our committee from Mr. McAdams. I am not sure I am keen on 14 years, but that was the compromise. I think 10 years is probably more in keeping with the tradition under these kinds of frauds. But I definitely appreciate his leadership on defining fine versus disgorgement versus restitution, which all nine Justices couldn't figure out. So, I appreciate that.

I also want to compliment Mr. Scott on financial literacy. Dr. Foster and I have been leaders on financial literacy bills in Congress. We support that wholeheartedly. And in Arkansas, we have Economics Arkansas, so we are proud to be one of those 17 States that, in fact, encourages economic curricula for our kids.

Commissioner Peirce referenced CATs, the Consolidated Audit Trail. I, too, have concerns about that. I was very concerned about Rick Ketchum and FINRA's proposal to do the CARDS proposal 4 years ago. This is just turning the card over, and it is a picture of a cat. It is all the same issue, which is, does government need to micromanage and have every trade for every person every day

when you already have the authority, in my view, at the Commission to look for trades under your market regulation, market surveillance functions, with the power that you have now? So, I am not a fan of CATs, as I was not a fan of CARDS.

During this Congress, we have had a lot of discussion about capital formation, and it is interesting—and corporate governance both in the committee over the past 9 months. Almost every proposal drives up costs of compliance and drives up costs of preparing a 10Q or a 10K for investors.

And I find that frustrating, because for the prior 10 years this committee, on both sides of the aisle, talked about, how do we maintain transparency, maintain materiality, and maintain important information for investors, but lower accounting costs, lower disclosure costs? How do we get at lowering officer and director liability, corporate liability expenses? How do we lower the costs associated with going public from a market reg point of view?

So, I am concerned that we are going in the wrong directions in the debates here, and I urge the Commission to use your economic analysis, your cost-benefit power that you have to be focused on lowering the costs of being a public company, reduce barriers, and let's not blame Reg D streamlining in the 1990s for why we have fewer public companies. Let's embrace more of the Jobs Act and Jobs 3.0 approach.

This slide I wanted to put up, because over the last few days there has been a lot of conversation about this Business Roundtable report that was released back in August. And those on the left jumped on screaming victory, that, by God, they had cowered the Fortune 200 into doing things their way, to have a more socially sensitive boardroom. Those on the right screamed bloody murder, that, oh, my gosh, we are going to abandon shareholder returns.

And then this morning on CNBC, my old pal, Nell Minow, postulated a new cynical theory for the BRT release, which is that because CEOs can't maximize earnings anymore, because they can't buy their stock back, now they are going to tie earnings to some of these social goals.

I put this up from 1992. This was our publicly traded company in Little Rock where we had shareholders, customers, and bankers, all priorities of our company in the communities we served, to do what? Drive financial performance. And we were a top-rated, top-performing bank holding company. I don't think the BRT change was that big a deal.

I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Missouri, Mr. Cleaver, who is also the Chair of our Subcommittee on National Security, International Development, and Monetary Policy, is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman.

And witnesses, thank you for being here today.

On the 27th of February, I sent a letter to the Financial Stability Oversight Council (FSOC), of which you are also members, and the Office of Financial Research (OFR), and to the CEO of Facebook, Dave Marcus. I received an interesting response, and I would like to have it entered into the record, Madam Chairwoman.

Chairwoman WATERS. Without objection, it is so ordered.

Mr. CLEAVER. Let me just share just a bit of it, because I think it is critically important.

The Chairman says the U.S. Department of the Treasury is requesting a review of Libra and Calibra Wallet by FSOC and OFR. And it says: "We agree with you, Chairman Cleaver and Chairwoman Waters, that these projects should be subject to regulatory review." And they said that they would agree to furnish any and all information needed for any investigation or any review that FSOC or OFR may be interested in conducting.

And I thought that was significant, we agree with your view that FSOC and OFR are qualified to assess the development of this work and that FSOC can play a valuable role in coordinating among its member agencies to ensure regulatory concerns are addressed. And then, they concluded by saying, "We will not launch until we have addressed all U.S. regulatory concerns."

Now, Mr. Chairman, I know you said you didn't want to become involved in any product, but I have a Bloomberg article from August 27th, where you addressed this issue of sorts. You said, "If it looks like an ETF and operates like an ETF, the law says it should be regulated like an ETF."

So, can you provide some greater clarity?

Mr. CLAYTON. Look, I think that is a—I like that statement.

Mr. CLEAVER. I do, too.

Mr. CLAYTON. I like that statement, because if what the product is, is something that is like an ETF on currencies, then we regulate it.

Mr. CLEAVER. They are saying they are not going to launch until they have addressed all regulatory concerns. Are there any concerns that have been expressed to Facebook as it relates to whether or not they are going to implement Libra?

Mr. CLAYTON. Yes. As Commissioner Peirce noted, we have a group that is looking at these things. And our doors are open. People should understand that, as a general matter, if a digital or crypto asset is looking like a substitute for something that is a security, they should come in and talk to us and find out whether their view of the world is the same as our view of the world.

Mr. CLEAVER. So would it be something—I mean, it is not anything that would be initiated by the SEC, is that what you are saying?

Mr. CLAYTON. It can go both ways. But I want to make it clear that our doors are open to talk about these things. And if somebody is going to launch something without coming to see us first, I think that is a bad idea.

Mr. CLEAVER. I do, too.

I yield back the balance of my time.

Chairwoman WATERS. Thank you.

The gentleman from Georgia, Mr. Loudermilk, is recognized for 5 minutes.

Mr. LOUDERMILK. Thank you, Madam Chairwoman.

And thank you all for taking the time to be here today.

I want to start off by talking about something that has been slightly touched on here that I think of all that you and we have a responsibility for, is probably the greatest threat to businesses,

investors, as well as average Americans, and that is cybersecurity. I think it is the greatest and growing threat to our nation, and to individuals. The threat of identity information, personally identifiable information, critical business, government, and personal data—sometimes I am a voice in the wilderness on this issue—is significant in this nation, and we have to spend a lot of time on it and pay a lot of attention to it.

Now, when I bring this up in different committees and talk about this, usually the response I get is, “Well, this is the investment we are making in cybersecurity or cryptology or in protecting the data we have.” But we overlook a basic premise of data security.

I spent 30 years of my life in the IT sector. I spent part of my time in the Air Force in intelligence where we dealt with securing data. A basic principle was, you don’t have to secure what you don’t have, meaning if you don’t absolutely need the information, then don’t get it, don’t keep it.

I am getting to CAT, the Consolidated Audit Trail. I am gravely concerned over the Consolidated Audit Trail, because you are talking about getting up to 60 billion records per day with a lot of PII in there, information on individuals, on businesses, on transactions. This, in my opinion, makes you a prime target for nation-state actors, for cyber criminals.

And in this environment, it is more than a full-time job to stay ahead of the bad actors. If you drop your guard for 1 second, a lot of people are harmed. Ask Equifax; they are proof of just laying down on the job for 1 second.

I know that the SROs have proposed eliminating the collection of Social Security numbers, account numbers, and dates of birth, moving forward with the Consolidated Audit Trail, but there are still discussions of including investor names, years of birth, and addresses, which still is a concern of mine.

Mr. Clayton, do you, does the SEC support the SRO’s (national securities exchanges) proposal of eliminating at least that information?

Mr. CLAYTON. Backing up, I agree with you that you have to ask yourself in this society, do we need the information to do our job? And fast forward, I support it because I think we need that information, what, name, date—not date of birth, but year of birth—and account to do our job. But I don’t think we need much more than that. So, I am supportive of that outcome.

I think that there was a lot more personally identifiable information that was in there, that as we drilled down we realized that by eliminating those fields, we were not eliminating our ability to surveil the markets.

Mr. LOUDERMILK. Okay. So the question is, do you need it? And the other follow-up question on that from a cybersecurity perspective is, is it data that you need to store or is it data that you can obtain when you need it without having the risk of actually restoring the data?

Mr. CLAYTON. And that is a question that we asked ourselves, do we have some kind of retrieve function to get the data? But you do need data—you do need enough data to know whether to retrieve something.

So at that point, you are going from just account number to name and year of birth. We have to reach out for name and year of birth more. We are trying to strike the right balance.

Mr. LOUDERMILK. Okay.

Commissioner Peirce, I know that you have expressed some concerns about the Consolidated Audit Trail. I want to give you an opportunity to opine on my concerns.

Ms. PEIRCE. I think you are raising exactly the right questions. We have to ask, do we need the data? If we don't need it, we shouldn't collect it. We have a system now that allows us to get data when we need it. It is the Blue Sheet system. We can do some work on it. It still does need some work. But I think it is a workable alternative, query why we need all of this retail investor information. I just don't think we need it, and I worry about it being an extremely attractive target.

Mr. LOUDERMILK. Well, thank you both. I am going to keep an eye on this and how it progresses, because I see that in a lot of instances in our government, we just love collecting data, and 90 percent of that data sits and it never goes anywhere.

Thank you.

I yield back.

Chairwoman WATERS. The committee will stand in recess for 5 minutes.

[brief recess]

Chairwoman WATERS. The committee will return to order.

The gentleman from Connecticut, Mr. Himes, is recognized for 5 minutes.

Mr. HIMES. Thank you, Madam Chairwoman. And I would like to thank all the Commissioners for appearing before us today.

Mr. Chairman, I have had the privilege of serving with at least three Chairs and a whole bunch of Commissioners, and I would really like to thank you for your work. This is as transparent, engaged, and helpful a Commission as I have had the privilege to work with. So, thank you for that.

I want to focus on an issue that I have been working on for the last several years, which is the issue of insider trading. As you all know, insider trading erodes faith in our capital markets, it often rewards insiders at the expense of retail investors, and is a real problem.

And what our witnesses know well but the American people may not it is that there is no statutory prohibition on insider trading. The SEC can and does prosecute insider trading through their anti-fraud and anti-manipulation authority, but the case law that shapes this insider trading law is far from a solid foundation. In fact, decisions like *U.S. v. Newman* can radically alter the landscape of what is unlawful almost overnight.

I am a believer that if we are going to prosecute someone for a crime, we should put that crime into statute, and that is what I have been working on for these last several years. And I am very grateful, both for the support and cooperation of the Commission, as well as the support of Chairwoman Waters and Chairwoman Maloney, as well as the cooperation of Ranking Member McHenry.

As you know, we marked up a bill in the beginning of May, and in the spirit of getting a bipartisan agreement, we continue to work

with the Commission and with my Republican colleagues to further refine the bill. I know you don't want to comment on particular legislation, but I want to get thoughts on some ideas that remain in discussion as we contemplate the bill, and those ideas are exclusivity and preemption.

Chairman Clayton, let me start with you on the topic of exclusivity and just ask you to opine on whether requiring that insider trading cases only be charged through the provision of law as envisioned in this bill instead of also being able to rely on anti-fraud and anti-manipulation authority, would that help or hamper your ability to prosecute insider trading cases?

Mr. CLAYTON. I commend you for grappling with the issues that are most sensitive in insider trading, which is when is the information that gives somebody an advantage acceptable for them to have that advantage. Like, I go count boxcars and find out whether a company is lying, and if they are lying, short the stock, and we want to encourage people to seek information, or information that is obtained in a bad way, which is, you are the CEO of a company and you have information ahead of people and you trade ahead of them. We don't want that.

You are grappling with that issue and you are grappling with the issue of, once I have impermissible insider information, when I pass it on, how liable are the people I pass it onto? And I think you are doing a terrific job on grappling with both of those issues that the courts have also grappled with.

A lot of what has been built up over time, I wouldn't want to lose, in terms of what we think is a good way to obtain information and what we think is a bad way to obtain information. So that frames my answer to exclusivity. I don't want to lose that body of law that we have built up over time.

I understand the *Newman* decision was one that gave people some consternation. I think that consternation has been greatly narrowed in subsequent decisions. But my answer to your question is, let's not give up what we have learned over the course of the last 30 years enforcing this law in trying to improve it.

Mr. HIMES. Thank you. Thank you, Mr. Chairman. I appreciate that.

The other issue is, of course, the age-old issue that we struggle with all the time, which is preemption of State law. Commissioner Jackson, let me turn to you on this one. We are discussing that issue, which we always discuss. So my question, I guess, is if the bill, in fact, preempted the authority of States to investigate and prosecute insider trading, is it your sense that that would be a good thing, or would it sort of compromise our overall ability to deal with insider trading as a threat to capital markets?

Mr. JACKSON. Congressman, thank you for your work on this. I agree with the Chairman that what we really want to do is build on longstanding law we have had in this area rather than undermine things we have.

And the reason that is true, Congressman, is that what we are trying to achieve is clarity, both for people inside companies and for ordinary investors. We want to let people know what the law is. And if we make significant changes, for example, by getting rid

of tools that already exist and have existed for many years, I think that will create more, not less, uncertainty.

Mr. HIMES. Okay. I only have 20 seconds left here, so I want to thank you for those answers. I think those are important contribution to getting us to a point where we can move forward with a bipartisan bill, which hopefully—and it has always been our intention here to not communicate but to make good law. And so, I appreciate the cooperation of the Commission. We will continue to work with you and hopefully clear up some of the legal ambiguity in this area.

With that, Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Ohio, Mr. Davidson, is recognized for 5 minutes.

Mr. DAVIDSON. Thank you, Madam Chairwoman.

And I thank the witnesses.

Chairman Clayton, as a successful Midwestern entrepreneur, I want to thank you for your role thus far in improving capital formation, particularly for small enterprises. Notably, raising caps from \$75 million to \$250 million was a big win.

I do, however, want to highlight some risks. Recently, Director Bill Hinman stated in a fireside chat that the SEC prefers an approach to digital assets through facts and circumstances rather than a bright-line test. This company-by-company approach prevents regulatory clarity, and it suffers from some of the charm and inefficiency of third-world power structures.

For this reason, although innovators are in America and innovation is still occurring in America, capital is fleeing, not to avoid our regulations but to find efficient regulatory clarity, and they are finding it elsewhere. We need a simple set of rules that apply equally and clearly to all. That is the premise of a bill that I know you won't talk about, but the framework that the market needs.

Where is the capital going? Places like Singapore, the U.K., and Switzerland have laid out clear frameworks for digital assets. Meanwhile, in the United States, hundreds of companies await no-action letters, with only two having been issued thus far by the SEC. I agree with you that the ICO situation represents bad outcomes, but the root issue remains that America does not have a clear regulatory framework.

Consumers and investors are harmed by that status quo. In fact, Director Peirce nailed the explanation. The SEC should not only be concerned about fraud but also about opportunity. Our failure to provide regulatory clarity fails Americans on both counts. We have not become the world's land of opportunity, the best destination for goods, services, capital, intellectual property, and more by anarchy or by inaction. With respect to digital assets, it is time for deeds, not words.

Commissioner Peirce, in your opening remarks you said enforcement is a poor way to announce policy. Would a law passed by Congress be an effective way to announce policy? Would that better enable the SEC, or for that matter other regulators, to focus on consumer and investor protection?

Ms. PEIRCE. It is always better to have a clear law that spells out what is and is not permissible, and I think then that enables

people to make decisions around that law and then we can enforce around that as well.

Mr. DAVIDSON. Thank you.

And, Commissioner Jackson, you referred to essentially the same sentiment that, what the law is provides these signals for the market. And that is why I have introduced the Token Taxonomy Act. It is a bipartisan bill with broad support that provides a simple set of rules for digital assets that apply equally and clearly to all.

Moving onto another concern, last Congress I introduced the Market Data Protection Act, which passed the House, but unfortunately it did not clear the hurdle in the Senate. The bill required the SEC, FINRA, and the consolidated audit trail's operator to implement internal risk control mechanisms to safeguard market data before the consolidated audit trail could accept any such data.

This spring, Congressman Loudermilk, who just spoke with you from our side of the aisle, and I, sent a letter seeking the same assurances. I will submit further questions on this critical risk for the record and your subsequent response. But I am encouraged by the direction that the SEC has taken on this.

So when you look at what was taking place when you first came in, I remember your first time here was one of my early hearings on the committee. And you had just found out, it had just been news that well prior to you taking office there had been data breaches of the EDGAR (Electronic Data Gathering, Analysis, and Retrieval) System.

And so, even the internal controls inside the SEC, just like all the controls once cyber is there, highlight how important it is to protect—diminish the amount of information that is collected because then you have to safeguard it. And I appreciate the attention you have paid to separating personally identifiable information from that data.

When you link the two concerns I have talked about, I do hope that blockchain can play a role in the data security concerns that the country has. I truly believe that if we provide the regulatory clarity that the market is clamoring for, that we will see an era of flourishing and blockchain much like what our country has seen with the internet.

And America's interests were highly advanced by our providing that regulatory clarity. Otherwise, the innovation is going to happen elsewhere. And I believe failure to act has already accelerated that transition.

So with that, I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Illinois, Mr. Foster, is recognized for 5 minutes.

Mr. FOSTER. Thank you, Madam Chairwoman.

And thank you to the full Commission for appearing today.

Commissioner Jackson, there has been a lot of talk about mandatory arbitration of late. As you may have heard, the House has recently passed the FAIR (Forced Arbitration Injustice Repeal) Act, and I am sponsoring the Investor Choice Act, which would prohibit public companies from requiring mandatory arbitration in shareholder disputes. So from your perspective, could you tell us why al-

lowing individual enforcement of securities laws in our courts is good for the public?

Mr. JACKSON. Thank you, Congressman. And thank you for your leadership in this area. It is extremely important. For me, here is what this comes down to, sir: What we are trying to do in this country is deter corporate insiders from committing fraud against their investors. It is good for the market, it is good for the companies, and it is good for investors.

And there are many different tools we have across our market to achieve that. We have public enforcement of the securities laws, which our tremendous staff works at every day under Chairman Clayton's able leadership. We have private enforcement of the securities laws that occurs in our courts.

And I guess, I would say to those who want to do less with private enforcement, you kind of have three choices in this area: you can be for public enforcement of the securities laws; you can be for private enforcement of the securities laws; or you can be for fraud. And I, sir, would prefer the historical approach we have taken in this country, which is a mix of public and private tools that make sure investors are protected.

Mr. FOSTER. And isn't it true that individual suits on issues related to corporate fraud help return a very large portion of the ill-gotten gains to investors?

Mr. JACKSON. Yes. And, in fact, as a matter of the data in this area, Congressman, the amount returned through private lawsuits is quite substantial and compensates American investors all the time.

Mr. FOSTER. Okay. And it is my understanding that currently there are few, if any, public companies that actually require mandatory arbitration in their governing documents. And so to a large extent, this bill would simply be codifying longstanding practice. Is that also your understanding?

Mr. JACKSON. Without commenting on any particular legislation, I think it would be very important to send a clear message to companies about what the law is in this area. And to the degree that any pending legislation would do that, I would be very supportive.

Mr. FOSTER. Yes. And, Chairman Clayton, I would like to bring up the issue of the consolidated audit trail again. First, could you just give us a very brief schedule update, which has not been a thing of glory for the last decade.

Mr. CLAYTON. Yes. It is way behind where it was supposed to be. But we have made some ground recently, and I think that we have coalesced around a schedule with the SROs.

Mr. FOSTER. What are the key milestones there?

Mr. CLAYTON. The key milestones—there are a series of milestones. I can't remember them off the top of my head, but it starts with basic order data and goes through to a more complex thing. But it is essentially a series of, let's just say, three to four milestones that we now have clarity and agreement on when we expect them to be completed.

We recently proposed—and I want to thank everybody here for supporting this—a rule that would align financial incentives with keeping to those milestones. I think one of the issues here is that

the financial incentives and the obligations may not have been as aligned as you would have wanted them to be.

Mr. FOSTER. Yes. Thank you. And one of the key issues here has to do with the beneficial entity behind the trades. And it is my understanding from your testimony that there has been some motion away from—in terms of the personal identification of individuals there.

And so, there are sort of two issues there. First, do you still plan on having a unique identifier for every market participant so you can, for example, identify wash trades and things like that?

Mr. CLAYTON. What we want to have is enough individual information where you can see where the trade is coming from. And I think what we have settled on is a unique identifier—

Mr. FOSTER. There will be a unique identifier with the intention that no trader should be able to operate multiple unique identifiers internationally? Because it seems like that is a key part, and a tough nut to crack.

Mr. CLAYTON. Yes. Yes, it is a key part and a tough nut to crack, and we want to get there.

Mr. FOSTER. What is your plan, and what is the status of international agreements that might allow you to get there?

Mr. CLAYTON. Now, you are actually raising another question, I think, which is, if people outside the U.S.—and this bothers me.

Mr. FOSTER. Sure. Clearly, you can manipulate a price in the U.S. and make a derivative bet in London, and unless the regulators can see it is the same beneficial person, then regulation doesn't work. And so, you must have a plan in the works to deal with that, I assume. What is the status of it?

Mr. CLAYTON. The status is, we need to deal with that. Do I have a specific plan? No, but it is an issue that is very important to me.

Mr. FOSTER. All right. Thank you. I yield back.

Chairwoman WATERS. Thank you.

The gentleman from North Carolina, Mr. Budd, is recognized for 5 minutes.

Mr. BUDD. Thank you, Madam Chairwoman.

And, again, thank you to our witnesses here.

Chairman Clayton, it is good to see you, and, again, thanks for the work at the SEC. I was pleased to see you take steps to ensure appropriate oversight of proxy advisers and establish much more needed rules of the road for this industry in your recent August 21st guidance.

Proxy advisory firms have gained extraordinary and unchecked power in recent years, and I am concerned that shareholders and fiduciaries are relying on their recommendations, which often contain factually incorrect information.

While the recent SEC guidance is an important first step, I urge the Commission to expand efforts to increase transparency into proxy advisory firms and ensure that they operate in a transparent manner and provide accurate information to support voting decisions.

In your view, what more can the SEC do in this arena, and how can the Commission work with Congress to bolster these efforts?

Mr. CLAYTON. Let me start by thanking Commissioner Roisman, who has taken the lead in this area.

And then in response to your question, I think the roundtables that we had last year where we got a lot of input from various market participants, really show the areas that need attention. Do investors understand how the securities that they are invested in are being voted? They should understand that.

Is our proxy plumbing where it should be? My answer to that is, it is not. We should be able to know that when there is an election, the votes that are being cast are indeed representative of the number of shares and the ownership of those votes. We should be able to solve that problem. I think that is fairly straightforward.

And then, just overall hygiene around the engagement process and have we calibrated it correctly. We really haven't looked at the calibration around the shareholder engagement process with any great rigor in about 20 years or so. So, a lot has changed. We have the internet. We have dissemination of information very quickly. We probably shouldn't have rules that were written for the mails.

Mr. BUDD. Thank you.

Commissioner Roisman, I also want to thank you for your leadership on this issue, and you just got a nice shout-out on that. So, same question: Does the recent guidance from the SEC on proxy advisory firms adequately address this issue, and what more can be done to increase transparency and accountability for proxy advisory firms?

Mr. ROISMAN. Thank you for the question. And I think the Chairman did a very good job of summarizing where we stand. I think we have had an interest in this area for a long period of time. I know members of this committee over many Congresses have as well, and, in fact, there have even been GAO (U.S. Government Accountability Office) reports to kind of delve into this.

So what I would say is, I think what we did in August was an important first step. I think we are constantly looking at other things, such as the proxy plumbing. We have heard suggestions, things like end-to-end confirmation, making sure that when people vote, those votes are counted. I think that is just critical to market and frankly voter integrity.

And then, things along the lines of potential other rules in terms of shareholder engagement. It is on our regulatory flexibility agenda. And to the extent that we get more comments on it, we always input that in and make our best decision.

Mr. BUDD. Thank you very much.

Commissioner Peirce, again, welcome. In April, FinHub (the SEC's Strategic Hub for Innovation and Financial Technology) published a framework for investment contract analysis of digital assets, which included 60-plus factors for determining whether or not the SEC would consider a digital asset to be a security.

In a statement released alongside your framework, your colleagues, Bill Hinman and Valerie Szczepanik, indicated that the framework is not intended to be an exhaustive overview of the law but rather an analytical tool to help market participants assess whether the Federal securities laws apply to the offer, sale, or resale of a particular digital asset.

Based on your discussions with market participants following the release of the framework, has the guidance helped resolve their most important questions, and would it have been more useful to

indicate in the framework how the SEC would weigh these 60-plus factors?

Ms. PEIRCE. I think weighting is one of the things that people have told me that they really would like to have. The guidance was well-intentioned, wanting to give more clarity, but I think it did muddy the waters.

Mr. BUDD. Thank you.

Last question, when can market participants expect an exhaustive overview of the law so that they can get the regulatory certainty required to continue to innovate and to create American jobs?

Ms. PEIRCE. Yes. As I said earlier, I am hoping that we can work to create some kind of safe harbor, which I think would be probably the best way we could provide clarity. But I am open to other suggestions about ways that we could provide clarity, particularly for utility tokens, which I think are a little bit different than some of the other types of digital assets we sometimes think about.

Mr. BUDD. Thank you. I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Illinois, Mr. Casten, is recognized for 5 minutes.

Mr. CASTEN. Thank you, Madam Chairwoman.

And thank you all for coming here today.

One of the first hearings that we had here was with Jay Powell, and I had heard, shortly before that day on the Science Committee that I also sit on, that even if we eliminated all CO2 emissions tomorrow, we already have 2 feet of sea level rise baked in. And that is not only coming, but it is accelerating.

And I asked Chairman Powell, given that Fannie Mae and Freddie Mac are in receivership, whether we should think about 30-year mortgages in Miami differently than we think about them in Denver. And his response, which I will paraphrase, was something along the lines of, that is a good question.

I mention that because I have a real concern that we don't properly evaluate the risks that companies are exposed to from climate change, and it is why I introduced in the House the Climate Disclosure Act to try to quantify that risk.

Commissioner Jackson, we know that ESG protocols provide qualitative disclosure of climate risks. Do you believe that adding quantitative and consistent disclosure is a good thing?

Mr. JACKSON. Again, Congressman, without commenting on any particular pending legislation, the answer to your question is, yes, sir, that it is clear to me that the best way to hold companies accountable for the decisions they make in this and many other areas is to get them to quantify their decisions and disclose that number to shareholders.

Mr. CASTEN. Okay. And to be clear, I am as concerned about investors. I am not—naming and shaming is something that can be done, but if I am an investor in a company that has a disproportionate exposure to climate risk, I would like to know that.

If investors don't have access to that information—of course, this is not just flooding. This is seed companies that may not have seeds that can grow and the increasing droughts that we have in

Illinois and floods we have in Illinois. How does the lack of basic access to that information potentially impact investors?

Mr. JACKSON. Well, what it does, Congressman, is make it difficult for investors to understand the risks they face in the companies they own. And that is why I think your leadership in this area has been so important. It is crucial that we let ordinary investors understand what the sustainability complications are of corporate decisions.

And let me say something, I am not the only one who thinks that. My own view is that we should be asking investors what they care about in this area. And, sir, here the evidence is crystal clear. You can see that many of the SASB (Sustainability Accounting Standards Board) standards have led to unusual returns, abnormal returns, and that shareholders care about this. Very frequently, shareholder proposals ask for more transparency in this area. It is very clear to me that ordinary investors care about these details, sir.

Mr. CASTEN. Thank you. And the hope, again, assuming that we get this through—we have it off of committee—we don't get to decide which accounting standard we are going to use. You all have a predilection for GAAP (Generally Accepted Accounting Principles), which I appreciate. We do at this point still have wildly different ESG reporting standards, and the hope is that we can standardize and come up with a consistent tool so that when investors are trying to figure out what their exposure is to a rapidly changing world, they can quantify that in some kind of a consistent fashion.

Do any of the rest of you have any comments, in the time I have left?

Mr. CLAYTON. I will just say that I encourage shareholder engagement on all issues of this type with companies.

Mr. CASTEN. Okay. Thank you, and I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Ohio, Mr. Gonzalez, is recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Madam Chairwoman.

And thank you, everybody, for being here. It has been a very good hearing.

Chairman Clayton, I was very happy to hear your comments and your interest in seeing more companies go public and stay public—I share that—so that Main Street investors can participate in some of our fastest growing, most exciting businesses.

When I talk to investors in these companies, private companies, or the CEOs or CFOs themselves, I hear kind of two areas: the first one is a barrier on the lack of research and liquidity in the market if you are a smaller micro cap firm, as well as research; and the second one is what I would call just general pains associated with raising a public round, going through the IPO process as opposed to staying in the private market.

My first question is, what is the SEC doing to increase the volume of the trading and the coverage from a research standpoint?

Mr. CLAYTON. Okay. You raise a point that I am going to take a minute of your time to explain.

Mr. GONZALEZ OF OHIO. Just one, though.

Mr. CLAYTON. Sorry. But trading in our top 500,000 names, it is really liquid. It is good. You can get execution. As you go further down the spectrum of public companies, trading is fairly thin and—

Mr. GONZALEZ OF OHIO. Thin and volatile.

Mr. CLAYTON. —in fact, making a trade in any size that is meaningful can have an impact on the price. If you know going in that it might be difficult to go out, you are less likely to go in. And that is sort of the issue.

We are looking at ways to deal with what we refer to as thinly traded stocks, and one of the questions we have is, is our architecture with a lot of exchanges and even more trading venues that seems to work really well for those top names, the right architecture for the more thinly traded names?

Mr. GONZALEZ OF OHIO. Thank you.

If I could put you in the seat of a private company CFO of a fast-growing business, pick a name, it doesn't matter, right, call it slack pre-IPO, I would argue that if you are a CFO thinking about, okay, where do I want to raise my next \$100 million, I either do it in the private markets or the public markets.

If I do it in the private market, I am shooting out 10 emails to my favorite ambassadors, having a couple of meetings, putting a slide deck together. You can probably go through that whole process in a couple of months if you are that kind of business. Do the same thing on the public side, you want to go IPO, you are going to spend millions of dollars hiring staff, attorneys, putting a book together, shopping it, and doing the road show bit.

In that world, using that analogy, what should we be thinking about to kind of close the disparity? Because I would argue, and from my conversations I have heard, that that kind of difference is one of the things that would keep a company private as opposed to public.

Mr. CLAYTON. You articulated it very well. Let's look at who is making those decisions. It is the people who own those private companies and are running those private companies, and they want to grow them, and they are saying, where is the best place for me to get growth capital that allows me to pursue my vision for growing this company?

And as we look at our public market rules, we need disclosure, we need fairness, we need good financial statements, we need all of those things, but are we doing more that makes that choice I am going to stay private because I am worried that I am going to lose my ability to pursue my vision in the way I want to?

Mr. GONZALEZ OF OHIO. Right. And then, Main Street investors can't participate.

Mr. CLAYTON. And then, Main Street investors can't—and the great thing about our public markets is the Main Street investors, they sit side by side.

Mr. GONZALEZ OF OHIO. And then my final piece, I want to go to crypto, which we have talked about a lot. I think Mr. Davidson hit it well. Blockchain is here. It is a technology that is being developed. But now folks are moving to Singapore, Switzerland, and the U.K. because of the clarity.

My concern is what I heard earlier, that until we see it operate, we don't know whether or not it is a security. When I talk to the

companies, what they would say is, well, we are not going to operate until we know whether we are going to be dinged as a security or not.

So we have this chicken-and-egg situation. They move overseas, and they will say, well, we will build our businesses over here. Once the U.S. figures it out, we will consider coming back. That I find concerning, and I guess I would ask, when can we expect more guidance? We have only had two no-action letters. When can we expect something a little bit more concrete from the SEC, or what are you doing to get there so that we can just provide some certainty here?

Mr. CLAYTON. Well, one of the more difficult things about this though is that each project is a bit different.

Mr. GONZALEZ OF OHIO. They are, but your job is to get this right.

Mr. CLAYTON. Believe me, we have people who are focused on doing this, like Commissioner Peirce. Utility tokens, tokens that are truly for use and get rid of the frictions needed with moving around—I may have too much computing power, you may have too little, and I am unable to shift it to you with the token in a very—great. Fabulous. But if you are trying to build a server farm with those tokens and give people the return, that is a—

Mr. GONZALEZ OF OHIO. Thank you. I know it is hard. With my final second, I just want to encourage you to go faster.

Mr. CLAYTON. Okay.

Mr. GONZALEZ OF OHIO. We need it. Thank you.

Mr. CLAYTON. Thanks.

Chairwoman WATERS. The gentleman from California, Mr. Vargas, is recognized for 5 minutes.

Mr. VARGAS. Thank you very much, Madam Chairwoman.

And I want to thank the Commissioners for being here and for the work that you do. Thank you very much. It is very important.

As you stated in your testimony, the first responsibility in the SEC's mission is to protect investors. The Securities Act of 1933, which preceded and set the groundwork for the legislation that would create the SEC, requires companies to disclose all material facts about securities so that investors can make fully informed investment and voting decisions.

Recently, it has been made clear that many investors view environmental, social, and governance (ESG) matters as important for evaluating reputational risk and financial performance.

Commissioner Jackson and Commissioner Lee, you issued a joint statement on the SEC's recent proposed changes to Reg S-K. You applauded the Commission for adding disclosure on the critical topic of human capital. However, you both raised concerns that the proposed approach gives company executives discretion over what they tell investors.

You also highlighted that the proposal does not seek comment on whether to include the topic of climate risk. Can you please explain these issues and why they are problematic for investors? Commissioner Lee, why don't you go first?

Ms. LEE. Thank you. And thank you for your attention to that matter.

It is very clear, we have heard from those managing hundreds of millions and trillions of dollars worth of investments that these are important parameters that they need in order to make investment decisions based on the long-term sustainability and value-building efforts inside of a company.

There were certainly a lot of good points raised in that proposal, which I agreed with, and I do appreciate the inclusion of human capital. I think comparability is extremely important for investors.

And that is why Commissioner Jackson and I both thought it was important to at least put that out there to get some comments on, because it won't help if each individual executive inside a company is making their own decision about what is material. It makes it very difficult for investors to compare. You have to balance that, but I am concerned about a shift that goes strictly to principles.

And I did regard also the issuance of that proposal as a missed opportunity to also isolate and highlight what we have been hearing from investors for quite some time now, that they need and want more about climate risk.

Mr. VARGAS. Thank you.

Would you like to add anything to that, Commissioner Jackson?

Mr. JACKSON. Well, sure, Congressman. Commissioner Lee has gotten this one right. But at a broader level, we could just ask the following question: When it comes to figuring out what is material, who decides? And I think the law and history of our markets is very clear: Investors do, sir. Investors decide what is important to investors. That is why Commissioner Lee and I issued a statement wondering why we didn't go further in this area given that it is so clear that investors care about these risks.

Mr. VARGAS. Thank you. I know you are not going to comment about specific bills, but I do have one on that. But I would like to ask about diversity, the issue of diversity. Again, I think that is something very important. And we have, in fact, seen that it is a valuable asset to a company. Would you like to comment on that, Commissioner Lee?

Ms. LEE. Yes, I wholeheartedly agree that it is an important and valuable asset for companies. And I think more disclosure on that, both at the board level and with respect to the workforce would be valuable to investors because I think it is quite clear that that helps build value inside companies. So, I strongly support that.

Mr. VARGAS. Commissioner Jackson?

Mr. JACKSON. Thank you, Congressman.

I absolutely agree that we need to do more in this area. Before I joined the SEC, I was a member of a group called the Thirty Percent Coalition, which states as its goal to make sure that 30 percent of board seats in the United States are held by women. And, sir, I think it is a scandal that we haven't reached that goal yet.

I agree with Commissioner Lee that diversity is enormously valuable to our companies and that we should do more to encourage diversity at all levels throughout public companies.

Mr. VARGAS. Thank you.

And, again, with respect to ESG, Mr. Chairman, why don't you handle the issue of the committee recommending or not recommending the mandatory disclosure of corporate political spending?

I think that Commissioner Jackson gave a quite impassioned speech at the beginning about money that oftentimes is spent in significant amounts, that ultimately the investor doesn't know where it is going and, in fact, might be contrary to the investor's opinion. Could you comment on that?

Mr. CLAYTON. I'm sorry?

Mr. VARGAS. Did you hear—maybe Commissioner Jackson—well, I only have 20 seconds left. Why don't you help him? I think he may not have heard the question.

Mr. JACKSON. It may be, Congressman, that what you have in mind is my description earlier for proposals to require companies to disclose their spending on politics when—

Mr. VARGAS. That is right.

Mr. JACKSON. —they use shareholder money—

Mr. CLAYTON. Oh, I thought—I'm sorry. I thought you said—where we stand today is if that is material, it is required to be disclosed. We also have had a fair amount of shareholder engagement on individuals—

Mr. VARGAS. Okay. My time has expired, but I guess you are not saying that that is material?

Mr. CLAYTON. No, I am not saying that—if it is, it should be disclosed.

Mr. VARGAS. No, not if it is. You are not saying that it is?

Mr. CLAYTON. I am not making a conclusion, no, about that.

Mr. VARGAS. Thank you.

Chairwoman WATERS. The gentleman from Tennessee, Mr. Rose, is recognized for 5 minutes.

Mr. ROSE. Thank you, Chairwoman Waters.

I want to begin today by reiterating my colleague, Mr. Luetkemeyer's, concerns about the implementation of current expected credit loss, and encourage you, Chairman Clayton, on that issue.

As I was back home in the Sixth District in recent weeks, and visiting with community bankers, I heard nearly uniformly from them concern about the implementation of CECL and, again, of uniform refrain, that they are ill-equipped to adequately forecast future economic activity, and that the end result of the current policy would be to increase the cost of credit for early-stage borrowers, start-up businesses, and small borrowers. And so, I encourage you to continue to keep up the pressure on the FASB folks about that, and I think it would be very smart if we studied that question a little bit more.

I want to applaud the Commission's efforts under your leadership, Chairman Clayton, to meet with the public outside of Washington, D.C. Hosting events like the historic investor townhall in Atlanta in June 2018 provide a unique forum for our constituents to engage with the Commission.

As a new Member of Congress, I can tell you that one thing I have learned is that nothing beats getting out of Washington and meeting with my constituents back home in the Sixth District of Tennessee. I hope you will continue these efforts as you work to better serve Main Street investors.

Chairman Clayton, I would like to drill down a little bit on the Office of the Advocate for Small Business Capital Formation. In my

district, there are 3 economically distressed counties in Fiscal Year 2020, down from 4 in Fiscal Year 2019. Small businesses are often the engines of growth in areas like the Sixth District. What is this office doing today to help small businesses in rural areas?

Mr. CLAYTON. Well, I hope a number of things, because there are a number of things that we need to do to foster small business capital. Navigating our regulations, we assist with that. But what is it that makes a small business grow? You need access to capital, you need access to human beings who can help you grow, and you need the expertise from lawyers and accountants and others who facilitate that type of engagement.

And what we have seen is that in areas where you have a critical mass of that, entrepreneurship flourishes much more quickly. So one of the things we are doing is we are trying to facilitate that type of engagement on a local basis.

If you look at the successful places, they have all of those elements. They have the professionals, they have the capital, they have the expertise. And one thing that is often missing is, if you have multiple small businesses in different areas, they feed off each other. There is a virtuous cycle to it. We are trying to help foster those kinds of ecosystems.

Mr. ROSE. I was proud to join with several of my colleagues here today to pass H.R. 2409, which added rural small businesses to the mission of the Office of the Advocate for Small Business Capital Formation. Chairman Clayton, is there anything more Congress should be doing to empower the SEC to be more proactive in these underserved areas?

Mr. CLAYTON. Here is what I will say: We are getting off the ground here. Martha Miller is doing a terrific job leading that office. If we keep doing a good job—we are always asking for money, but give us some more money to do a better job and build out that office.

Mr. ROSE. Commissioner Roisman, you noted in a speech this past April that there are fewer opportunities for retail investors to invest in companies in their early stages of growth and more generally in smaller IPOs, citing barriers to small business capital formation that the Commission should address. In your view, what should the Commission be doing to address this issue?

Mr. ROISMAN. Thank you for that question, and for touching upon this important issue.

I think we are always looking to see whether the current rules we have help foster more capital formation and promote the three-part mission of the SEC. I think we can do some things to help address some of the concerns people have who are smaller companies about—and give them certainty about what their requirements are going to be in terms of what they need to do to be a public company.

I also think some of the discussions earlier today are really helpful. Capital formation is inextricably linked to secondary market trading. So when you are a small company, it is harder to succeed in terms of having really good secondary market liquidity. That is something we should look at.

Mr. ROSE. Thank you.

And, Chairwoman Waters, I yield back.

Chairwoman WATERS. Thank you.

The gentlewoman from Massachusetts, Ms. Pressley, is recognized for 5 minutes.

Ms. PRESSLEY. Thank you, Madam Chairwoman, for your leadership on issues of accountability and oversight.

And thank you to the Commissioners for joining us here today.

I want to jump right into an issue that has led to a great outcry, and phone calls to my office from investment firms and religious organizations throughout my district, Massachusetts's Seventh.

Chairman Clayton, yes or no, are you familiar with the history of the shareholder resolution?

Mr. CLAYTON. I'm sorry, the shareholder—

Ms. PRESSLEY. The shareholder resolution, specifically the first shareholder resolution filed on a social issue.

Mr. CLAYTON. Actually, I need some help here.

Ms. PRESSLEY. Okay. In 1971, Episcopal Church presiding Bishop John Hines presented to the Board of General Motors a shareholder resolution filed by the church requesting that the company stop doing business in South Africa. Many members serving in Congress, including our very own chairwoman here, were on the front lines of this fight using every financial tool to force behavioral change on the part of corporations, and by extension, society at large.

My colleagues on the other side of the aisle often point to the role of the private sector in addressing any number of social and economic issues: Climate change, human rights, labor standards, all pressing issues, issues that everyday investors in public companies can currently inform.

Right now, all that is required to submit a shareholder resolution or to resubmit one on issues like these is to own \$2,000 in stocks. Your Commission wants to change that threshold. Some of our Republican colleagues have supported legislation that will require a 1 percent threshold to file a resolution. In other words, to file a resolution at Exxon Mobil, which has a market capitalization of \$347 billion, an investor would need to own over \$3 billion in stock.

Chairman Clayton, yes or no, do you think it is responsible to require an investor to own over \$3 billion in shares just to file a simple resolution?

Mr. CLAYTON. I am going to give you an answer you will, like but not a yes-or-no answer. That number is way too high as a responsible threshold for engagement.

Ms. PRESSLEY. What will the new threshold be?

Mr. CLAYTON. We are working on it. But what will the new threshold be? In my ideal world—we can't live in an ideal world, but in my ideal world, it would be a threshold that allows access for people who are long-term investors in a company and have a meaningful stake, but a meaningful stake at a personal level, but eliminates some of the, what I would say is—I don't like it that 25 or 30 percent of the proposals that we see are from a handful of people. I want people to have engagement and—

Ms. PRESSLEY. I am just wondering who you have heard from—

Mr. CLAYTON. I am seeing if we can improve this.

Ms. PRESSLEY. Okay. But I am just wondering, again, what informed this. I know who I have heard from in my district, the Mas-

sachusetts Seventh. I have heard from religious investors like the Sisters of Saint Joseph's; the AFL-CIO; the Sisters of Notre Dame; the Unitarian Universalist denominations; the Episcopal Diocese of Massachusetts; the First Parish Cambridge; and investment firms like Loring, Wolcott & Coolidge, Boston Trust/Walden, and Trillium Asset Management, who are all opposed to any changes to this process.

So who did you hear from other than the chamber and the National Association of Manufacturers in the business roundtable? Where is this coming from? What is the genesis?

Mr. CLAYTON. We have heard from a number of companies. And, look, on whether those entities will be able to make proposals, I am only speaking for myself. My colleagues can have their comments. I am not looking to keep those people from being able to make proposals.

I will say we are looking at the resubmission thresholds. I am looking at the resubmission thresholds more closely than the initial thresholds. And one of the reasons is those resubmission thresholds, they were set, like I said a few moments ago, at a time when the mails were how we communicated. People are fairly aware of what is being voted on—

Ms. PRESSLEY. I am going to reclaim my time because the clock is—no, I appreciate that. It is just that we are facing unprecedented crises, chief among them being climate change. And we need every tool and all tools available to us in this fight. And the SEC's mission is to first and foremost protect investors. So I urge you to reconsider any changes to the shareholder resolution process.

Thank you, and I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Wisconsin, Mr. Steil, is recognized for 5 minutes.

Mr. STEIL. Thank you, Madam Chairwoman.

Commissioner Roisman, I commend you for your work, particularly on proxy advisers. Proxy adviser firms are also sometimes providing consulting firms to some of the publicly traded companies that they are reviewing and analyzing. I just want to get a flavor of the committee, if that is a potential conflict that should be examined as part of this process. Commissioner Lee?

Ms. LEE. Yes. In the first place, I will say that both of the two largest proxy advisers, I believe they do make such disclosures. I think it is important that we do have transparency around conflicts, and I think that they have been for quite some time disclosing those conflicts.

Mr. STEIL. Thank you. Commissioner Jackson?

Mr. JACKSON. My answer to your question, sir, is, yes, these conflicts are serious, and deserve scrutiny from the marketplace generally, and certainly from securities regulators.

Mr. STEIL. Thank you. Chairman Clayton?

Mr. CLAYTON. Yes. I believe in disclosure of material conflicts across-the-board.

Mr. STEIL. Commissioner Peirce?

Ms. PEIRCE. Yes. I think that is what our guidance was trying to get at, that investment advisers need to think about those conflicts.

Mr. ROISMAN. I think they all said it well.

Mr. STEIL. I appreciate, Commissioner Roisman, you taking this topic on, and I look forward to seeing the results of some of your work on this.

I want to go back to earlier in this hearing, when there was a brief discussion about stock buybacks. To me, it is really an efficiency of capital allocation conversation. And so, I think the question comes down to, what is the role of the SEC in putting in place rules and governing management's decision on the efficient capital allocation as it relates to—across the board on that, if that is really the role of the SEC or if that is the role of private management to make efficient capital allocation decisions?

Chairman Clayton, could you comment as to how you approach that analysis?

Mr. CLAYTON. I think you framed the question pretty well. When a board of directors is thinking about whether to invest in a particular item, buy another company, pay a dividend, or return capital to shareholders through a stock buyback, that is not within our purview to regulate those decisions.

If they do decide to do a buyback, what is within our purview is whether they do so in a way that does not affect the market in an impermissible way, that doesn't, as we say, create manipulation. And our rule 10b-18 is a safe harbor, that says, if you comply with this rule absent intent or other circumstances, you are not going to be deemed to have manipulated the price of the stock.

Mr. STEIL. Thank you.

In your testimony previously, you wrote that you are motivated by the fact that tens of millions of Americans are investing in our capital markets and have to make personal investment decisions. I think it is an important detail to always keep in mind the number of Americans who are invested either individually through their 401(k), through their pension plan, in the United States publicly traded securities, and the critical work that you are doing.

Just recently, we were having a conversation in particular as it relates to resubmission thresholds. I want to open that back up to you, Chairman Clayton. As we think about this and the ability for management to stay focused on innovation and growth, not be distracted by kind of repeated, and we look at those thresholds, can you kind of just take another second to walk through your analysis as to what that resubmission threshold is and the impact that can have on management when there are repeat submissions?

Mr. CLAYTON. You have engagement. And hopefully, engagement with shareholders leads to more than just, here is a proposal, do this. It leads to tell us about this particular issue, how you can improve and have a more nuanced conversation. But sometimes, the ballot box is important.

And then the question is, it has been put to shareholders. It has not passed. How many times and what level do you have to get to to continue to put it to shareholders? And like I said, that has not been examined, I think, since—I will turn to Commissioner Roisman—since the 1950s?

Mr. ROISMAN. Yes.

Mr. CLAYTON. And one of the issues there was, we are using the mails, shareholders should be informed about what has been in front of management, how long—that information is disseminated very quickly today. There are proxy advisory firms. You can get that kind of information, and the question is, do we need to reexamine that or not?

Mr. STEIL. I appreciate your work. I think there is a real opportunity to reexamine that, to allow management to stay focused on actually operating the company rather than on some of these distracting and repeat proposals. I appreciate your work on that. I appreciate you all being here. And I yield back the balance of my time.

Chairwoman WATERS. Thank you.

The gentleman from New Jersey, Mr. Gottheimer, is recognized for 5 minutes.

Mr. GOTTHEIMER. Thank you, Madam Chairwoman.

And thank you to all of the Commissioners for being here today.

Chairman Clayton, millions of seniors across the country, including my own mother, have been the victims of financial scams and they have been cheated out of their rightful retirements. Do you agree that we should be doing everything possible to prevent our seniors from being robbed of their life savings?

Mr. CLAYTON. Yes.

Mr. GOTTHEIMER. Thank you.

Chairman, are you familiar with the Senior Security Act, and have you read the bill?

Mr. CLAYTON. Is this a pending bill?

Mr. GOTTHEIMER. No. It is a bill that passed out of the House of Representatives.

Mr. CLAYTON. There are a couple of bills of a similar type. Give me the—

Mr. GOTTHEIMER. Yes, sure. It is a bipartisan bill that I introduced with my good friend, Mr. Hollingsworth, that would create a senior investor task force at the SEC specifically designed to stop financial predators, hucksters, from scamming seniors out of their savings.

Mr. CLAYTON. Yes, I know this one.

Mr. GOTTHEIMER. It passed out of the House overwhelmingly bipartisan, 392 to 20. So anyway, that is the bill. In my work to pass the bill into law now, I understand that you may have said you don't have time for the senior investor task force to report to you, which the bill would establish. Do you know if that is true? Did you say that you don't have time for the senior investor task force to report to you?

Mr. CLAYTON. That sounds crazy.

Mr. GOTTHEIMER. I agree. That is what I heard, so I just wanted to check.

Mr. CLAYTON. Don't believe everything you hear.

Mr. GOTTHEIMER. So you can commit that you would be happy to have the senior investor task force report to you like other task forces do?

Mr. CLAYTON. Yes, sure.

Mr. GOTTHEIMER. Excellent. That will really help, I think, in getting this legislation passed.

As you probably know—

Mr. CLAYTON. Look, our door is open. People have—go ahead, I'm sorry.

Mr. GOTTHEIMER. No, please.

Mr. CLAYTON. That kind of engagement is important to our work.

Mr. GOTTHEIMER. Thank you, Chairman Clayton. I think it is very important that they report to you.

As you probably know, and according to a report from the Senate Special Committee on Aging released this year, seniors are scammed out of \$3 billion every year from financial scams and those who abuse seniors and prey on them, all of these hucksters. So it is a real issue, and I know it affects so many Americans.

According to a survey from the Investor Protection Trust, approximately 7 million Americans have reported being victims of exploitation. Not only that, but one in every 24 cases of elder exploitation actually gets reported. So, it is obviously a very important issue.

Mr. CLAYTON. We hosted folks from the Department of Justice and others about a year ago on this issue, and unfortunately, some of this is people they know well, and some of it is driven by things like opioid dependency where people are stealing from seniors. We are doing things, but we need to recognize these risks.

Mr. GOTTHEIMER. And I think this legislation—which, again, was very bipartisan—will really go a long way in helping in that effort. I don't know if any of your colleagues—Commissioner Jackson, I don't know if you want to add to that?

Mr. JACKSON. Congressman, I agree with the Chairman. Let me add one more thing. I think your focus and leadership on the issue is enormously important, and I have watched as the Chairman and his very able Enforcement co-Directors have worked through many of these cases. We see these victims, Congressman. You are right that we need to do all we can to protect them, and I doubt there is any disagreement among us on that subject.

Mr. GOTTHEIMER. Excellent. Well, I am not going to stop until we get this bill signed into law, and hopefully we can work together to make sure we get there and continue to help seniors save their hard-earned money for retirement, so obviously, they can stay in New Jersey where I live, in the Fifth District of New Jersey, and stay in their homes and enjoy their lives with their kids and their grandkids, which as you know, those who are scammed often, unfortunately, lose their homes and have to decide if they can pay for their medicine. So, it is a real issue.

I don't know if any other Commissioners want to comment on this issue. Commissioner Peirce?

Ms. PEIRCE. I think we are all committed to doing what we can to protect older investors. And the problems associated with that only become more intense as the years go by, as people are living longer, and as capacity issues come up. So there are a lot of complicated issues, and I think a task force to think about this could be helpful to us as we think about these issues as well.

Mr. GOTTHEIMER. Excellent. I think, hopefully, we can work together to encourage the Senate to pass and to vote on the Senior

Security Act and get this into law. I know Mr. Hollingsworth and I—as would many members of the committee—be very grateful. Thank you so much for your time, and I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you.

The gentleman from Michigan, Mr. Huizenga, is recognized for 5 minutes.

Mr. HUIZENGA. Thank you, Madam Chairwoman. And my apologies to the witnesses that, as ranking member of the subcommittee that oversees you, I was not here at the beginning for your opening statements. But I have a constituent, whose name is Sawyer. Sawyer is ten. And last year, she put together 25,000 care packages for members of the military, and she was asked to lay the wreath at the Tomb of the Unknown Soldier this morning. And I was honored to be asked by her to join her. So I love you all, and I appreciate what you are doing, but Sawyer's work took some preeminence this morning. So, forgive me for that.

But I want to quickly move through four items, if possible: ESG standards; Reg BI; money market funds; and if possible, the Advisers Act. It has been well-established that current law says shareholders can have their voices heard and their directives followed through this system of bringing resolutions to boards that has been of some discussion and debate.

It begs the question of, if investors have moved these ESG standards to the top of their list, as Commissioner Jackson had indicated, why aren't more companies adopting these standards formally? It is because their shareholders have voted them down. And I think it is very important that you look at those resubmissions for not just this issue but for others.

Commissioner Peirce, you have done a lot of work on this. And I am curious if the SEC writ large has any "expertise" in environmental or social goals such as that? And in your view, should we be developing mandatory disclosures based on that expertise? Quickly?

Ms. PEIRCE. Mandatory standards, I think, in this area just are not—they don't work.

Mr. HUIZENGA. Mary Jo White, the Obama-appointed Chair, had made that same observation regarding conflict minerals. And under this particular legislation that the committee has been looking at, these ESG metrics would be viewed or deemed de facto material. That seems problematic.

Ms. PEIRCE. I agree. Companies have been thinking about a lot of the issues that fall within the ESG umbrella for a long time. But they think about it, and we expect them to think about it through the materiality lens, is it going to be material to the financial long-term value of the company? That is how I view these things, and I think that is how we should view all issues that affect companies.

Mr. HUIZENGA. So, lots of discussion about what is material, and I appreciate that.

Reg BI, Reg Best Interest, I understand, Mr. Chairman, that there has been a lot of criticism about this regulation. And in your July 8th speech, you stated that much of the criticism—which is focused broadly on the extent of the investor protection fiduciary interpretation—is, "false, misleading, misguided, and unfortunately,

in some cases, is simply policy preferences disguised as legal critiques.”

Would you like to address those criticisms and set the record straight on Reg BI right now?

Mr. CLAYTON. For a detailed discussion, and I think a very thorough one, I would refer you to my speech. But let me just talk about Reg BI.

Mr. HUIZENGA. One of my colleagues earlier had said that you watered down the fiduciary duty as you put this package forward. Is that true?

Mr. CLAYTON. No, it is not true.

Mr. HUIZENGA. Okay. Well, go ahead.

Mr. CLAYTON. On Regulation Best Interest, and then the obligations of broker-dealers to their retail clients, we have an overarching obligation that they can't put their interests ahead of the clients. We have made a clear disclosure obligation where you have to say how you make your money.

We have a clear care obligation. We have to know your client and tailor the product recommendation to your client's needs, including where they may be in their lifecycle. Then, we have a conflict mitigation obligation that is directly in the rule. And finally, we have a policies and procedures obligation, because words are good, but unless you have an ability to test them against procedures, it is very difficult to enforce them.

That package was developed in combination with our Division of Investment Management, our Division of Inspections, and our Division of Enforcement to give real teeth to this rule.

Mr. HUIZENGA. In my remaining minute, back in 2017 when I chaired that particular subcommittee, and Congresswoman Maloney was the ranking member, we wrote to you on regulations the SEC implemented for money market funds (MMFs). And in your written response, you said, “The MMF reforms were not fully implemented until October of 2016 and I am concerned that making major changes at this time would be disruptive to the short-term funding markets.”

I agree with you, and so does Federal Reserve Chairman Jerome Powell, when testifying before this committee. Secretary Mnuchin has identified some of those same issues. Do you still believe major changes would be needlessly disruptive, and is there anything else you would like to add on that?

Mr. CLAYTON. I don't know that I want to say needlessly disruptive. But I think we should look at whether short-term funding in the space that it moved out of, which is it moved from kind of private to government and has indeed been impaired, and if it has, we should think about what we should do about that.

Mr. HUIZENGA. I appreciate the opportunity, and I will yield back.

Chairwoman WATERS. Thank you.

The gentlewoman from Michigan, Ms. Tlaib, is recognized for 5 minutes.

Ms. TLAIB. Thank you, Madam Chairwoman.

Detroit's housing crisis, I talk about it in this committee a tremendous amount of time, because a lot of it is interconnected with the work that we do here. But as many of you may or may not

know, the crisis is very real in my district, in the 13th Congressional District.

According to a 2018 report from the Urban Institute, Black home ownership rates in Michigan decreased from 51 percent in 2000 to 40 percent in 2016. Currently, the wait list for affordable housing is 6 months to a year.

Chairman Clayton, you stated that, “The Opportunity Zone Program has the potential to encourage investment in economic development in many areas across the country that are in need of capital.” I would consider my district one of those that are in need of economic development, so I would like to talk about that a little bit.

And I don’t know, Commissioner Jackson, if you could help me with this? So, according to the SEC, such qualified Opportunity Zones funds must comply with all applicable regulations of the SEC and the securities regulators in the States where they are doing business. Can you elaborate on what that really means?

Mr. JACKSON. Can you say a little more, Congresswoman?

Ms. TLAIB. On the SEC site, it says that they have to be regulated under the SEC and the security regulators in their States in doing business.

What does that really mean for Opportunity Zones?

Mr. Chairman, go ahead. You were the one quoted.

Mr. CLAYTON. Yes, that was something that we—we saw Opportunity Zones, people are raising money for them, and we wanted to remind them that you have to follow the investor protection rules that we and the States have. So we put this out to say that when you raise capital, be mindful of those rules and the disclosures.

Ms. TLAIB. But, Mr. Chairman, does the SEC have the authority to define and clarify Opportunity Zone funds that were established and expanded in the 2017 tax law?

Mr. CLAYTON. We do not have direct authority over the size or those types of things. What we do have authority over is how they raise their money for those projects. So when they go to investors and say, hey, we want to raise money for this project, it is an Opportunity Zone, are they doing it in a compliant way?

Ms. TLAIB. This is yes-or-no to any of the Commissioners, do any of you have knowledge if developers that qualify under Opportunity Zones are required to produce a significant number of jobs?

Do you know of any? Are they required to—do you know if they are required to provide, like, this is the number of jobs that we are going to provide with Opportunity Zones?

Ms. LEE. I can’t say that I am familiar with that.

Mr. JACKSON. Not to my knowledge, Congresswoman.

Ms. TLAIB. Chairman Clayton?

Mr. CLAYTON. I am not aware of that.

Ms. PEIRCE. I don’t know how that works.

Mr. ROISMAN. Nor do I.

Ms. TLAIB. So are developers who benefit from the Opportunity Zones required to help with poverty reduction in return of their tax break?

Mr. JACKSON. Again, Congresswoman, not to my knowledge.

Ms. TLAIB. None of you?

Okay. I have an issue with Opportunity Zones, and it seems oddly familiar, because in the 1980s, Enterprise Zones, which the GAO ultimately concluded made no significant difference in economic growth or job creation in surrounding areas, wealthy real estate developers made money from Enterprise Zones, but communities were not actually prospering because of it.

On that note, I want to submit for the record, Madam Chairwoman, a New York Times article that reported that Donald Trump and his family and advisers will benefit tremendously from the Opportunity Zones.

Chairwoman WATERS. Without objection, it is so ordered.

Ms. TLAI. Chairman Clayton, I was taken aback by the statement that you supported Opportunity Zones and see it as an opportunity, and you went on to say a lot of great things about it.

Wayne County is experiencing rapid gentrification, it is in my district, where lower-income communities are pushed out, while tax dollars are going to wealthy developers and corporations to build shiny new stadiums or luxury condos that they can't afford.

So my question is, why would you make the statement that you made in regards to Opportunity Zones being an opportunity for economic development? Because it is a tax break, right?

Mr. CLAYTON. Actually, one of the reasons I put the statement out was, hey, comply with the law, hey, capital formation is good. But if you look at the statement, there is also something that says our regulations make it hard for people who live in those jurisdictions to actually invest alongside the people who are investing in these Opportunity Zones. To me, that is an issue.

We want to help people make that opportunity available to the people who live in the zones in which they are investing. There are ways to do that.

Ms. TLAI. Yes, I think if you are going to talk about it in the future, then make it much more clear, because it sounds like you are supporting it without any kind of accountability, like follow the law. But in many ways we are promoting it as some sort of way to deal with those other issues that I think—

Mr. CLAYTON. But I recognize the issue, and I want to say, hey, let's find a way to let people in that community participate.

Ms. TLAI. Thank you.

Thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you.

The gentleman from Texas, Mr. Gooden, is recognized for 5 minutes.

Mr. GOODEN. Thank you, Madam Chairwoman.

As you all know, individual investors don't have shares in stock like they used to. Big firms, big investors, have the bulk of these shares, and they rely a lot on these proxy investors.

A few questions ago, you all said you supported transparency for these proxy advisory firms. Do you support further efforts to increase transparency among how their analyses are produced, about how they come to the conclusions that they come to?

I know a recent vote, I think it passed 3-2, worked on some of that. But are there any plans in the near future to increase transparency among these proxy advisory firms?

Mr. JACKSON. Congressman, it is a good question. I won't speak to the plans going forward. I want to take a moment to acknowledge Commissioner Roisman's leadership in this area. It has been enormously effective and important, and he has engaged across, with all five of us, really to help us get this right.

So, I think there is already some transparency of the conflicts you are describing, but I want to go back to what I said earlier. Any time a business model under our jurisdiction has a conflict, we need to get information out to the marketplace about that conflict. And I support that here as I do in other contexts.

Mr. ROISMAN. I appreciate the question. And I appreciate the comments from my fellow Commissioner, Commissioner Jackson.

But what I will say is I think we have done an important first step, with what we did in August. And part of it was reaffirming what the Commission's interpretation of the law is with respect to the use of proxy advisory firms by asset managers, and investment advisers.

What it comes back to is ensuring that if they are responsible for undertaking the vote on behalf of retail investors, they have to do what is in the client's best interest. They have to vote. And part of that is, I think, understanding what those conflicts are and whether those conflicts can be overcome or addressed or mitigated.

Mr. GOODEN. I think one of the concerns—and I represent the Dallas area. We have a lot of companies based there. And I have heard from leaders of many of those companies that these firms, they just put out their analysis and they often don't get any input.

Some of the things that I have heard that would be helpful is they maybe get a phone call and say, hey, this is what we are about to put out, do you agree with this? Maybe they are not going to change it, but perhaps they are missing something.

Another thing I think that would be helpful in your rulemaking process is giving a company an opportunity to respond to what is being put out about them and have it attached to whatever this analysis is, without edits.

I think we have gotten to the point where these proxy advisory firms have become such a big part of daily business, I have talked to CEOs who say, we feel like we answer to these firms. One of them is called ISS, and they, not jokingly, call it ISIS. And that is just a common term that these leaders of these companies use to refer to this particular company, because they feel like they are beholden to these proxy advisory firms.

And it also kind of goes hand-in-hand with the shareholder resolution process. We have gotten some of these radical shareholder proposals that these proxy advisory firms have such great influence over. And so, I want to encourage you to work on the rulemaking procedures. I know you said that \$3 billion is obviously too large. I agree with that.

But companies that are spending so much time and dollars fighting resolutions which don't help the company or don't help investors, don't help the employees—I saw a fact here that 56 percent of all shareholder proposals in 2017 were related to social issues with little connection to company performance.

And so much of this, when these proxy advisers are encouraging a vote one way or the other, I think it is important that we know

where they are coming from and that these conflicts of interest are disclosed. And I would ask that you all work on that, please.

I yield back.

Chairwoman WATERS. Thank you.

The gentlewoman from California, Ms. Porter, is recognized for 5 minutes.

Ms. PORTER. Chairman Clayton, you have spoken very highly about the importance of disclosure to maintaining healthy markets. And during a December investor advisory committee meeting, you said, "Disclosure is at the heart of our country's and the SEC's approach to both capital formation and secondary liquidity."

So, disclosure is at the heart of the SEC's approach. You made that statement in the context of speaking about ESG, or environmental, social, and governance disclosures.

Do you generally believe that ESG disclosures are a useful tool that provides information for investors who consider or want the option to consider using that information in investing their money?

Mr. CLAYTON. I believe that there are disclosures in each of those categories that, depending on the circumstances, can be quite meaningful to investors.

Ms. PORTER. Thank you.

Commissioner Peirce, you have compared ESG disclosures to scarlet letters, in the vein of the high school novel, "The Scarlet Letter," in which an unwed pregnant woman named Hester is marked with a red letter "A" for "adulteress." You said, and I quote, as with the scarlet A, "The ESG letters oversimplify complicated facts."

Do you remember making that comparison between ESG disclosures and the Scarlet Letter?

Ms. PEIRCE. I do.

Ms. PORTER. You actually said—and this is colorful—"We ought to be weary of shrill cries from a crowd of self-appointed, self-righteous authorities, even when all they are crying for is a label."

So, in your opinion, those who support ESG disclosures, the requirement that companies give investors information about, for instance, their environmental impact or their gender diversity, those people are shrill, self-appointed, and self-righteous.

Commissioner Peirce, would you consider Chairman Clayton to be shrill?

Ms. PEIRCE. Not at all.

Ms. PORTER. Do you consider Commissioner Jackson to be self-righteous?

Ms. PEIRCE. Not at all.

Ms. PORTER. Do you consider Commissioner Roisman to be self-appointed?

Ms. PEIRCE. Not at all.

Ms. PORTER. Chairman Clayton, do you consider yourself to be shrill or self-righteous?

Mr. CLAYTON. I try not to be.

Ms. PORTER. Would you call investors who request ESG disclosures to be shrill or self-righteous?

Mr. CLAYTON. I don't like to put a blanket on investors as a group, but I believe that people who engage on this, they care.

Ms. PORTER. They presumably want the information because they believe—

Mr. CLAYTON. They care.

Ms. PORTER. —that it is maybe useful to them.

Commissioner Clayton, Chairman Clayton, do you believe the letters ESG should actually stand for “enabling shareholder graft,” as Commissioner Peirce said during a recent speech at a think tank? Graft, of course, being the advantage one gets from corruption.

Mr. CLAYTON. No.

Ms. PORTER. Thank you.

Commissioner Peirce, you spoke in your opening statement about regulatory humility, that the SEC should be sensitive to the learning it can do from other sources.

You mentioned advisory committees as a valid source of information. Does your commitment to regulatory humility extend to the general public’s comments as investors?

Ms. PEIRCE. I welcome comments from the general public. I think they are very valuable as we think about how to regulate.

Ms. PORTER. So, the 1.2 million comments received in support of the disclosure of political spending by corporations, do you have enough regulatory humility to stand with the public who has requested those disclosures? Or do you think you are smarter than those million-plus people?

Ms. PEIRCE. Corporate political spending is not on our agenda now. I believe there is a legislative ban on us considering that topic.

Ms. PORTER. Moving to Mr. Jackson, are corporations required to disclose executive compensation?

Mr. JACKSON. Yes.

Ms. PORTER. Why?

Mr. JACKSON. Because there is a conflict between the interests of the investors and the insiders when it comes to how much the insiders are paid.

Ms. PORTER. So why is there not the same conflict between investors and executives when it comes to political spending?

Mr. JACKSON. Congresswoman, I believe there is, because insiders benefit from political spending that they favor.

Ms. PORTER. How?

Mr. JACKSON. They get the ability to use someone else’s money to support political causes that they prefer as opposed to the investors’ preferences.

Ms. PORTER. For example, a political cause like lower taxes on the wealthiest Americans, which may not, in fact, benefit the Main Street investors who are at much lower income levels?

Mr. JACKSON. That is certainly one possible example.

Ms. PORTER. So we require companies to disclose executive pay because we are worried that executives may overpay themselves, and that same misalignment of interests applies for corporate spending.

Mr. JACKSON. That is my view, Congresswoman, yes.

Ms. PORTER. Thank you. I yield back.

Chairwoman WATERS. Thank you.

The gentleman from Utah, Mr. McAdams, is recognized for 5 minutes.

Mr. HUIZENG. Madam Chairwoman, parliamentary inquiry. I was informed that there was a 1:30 hard stop that had been negotiated. What is the status of that?

Chairwoman WATERS. Yes, we had a 5-minute break. And so, we are going to make up with Mr. McAdams, and then we will excuse our witnesses for today.

Thank you very much.

Mr. MCADAMS. Thank you, Madam Chairwoman.

Thank you, Chairman Clayton and fellow Commissioners, for being here today.

The work of the SEC is vital to ensuring our capital markets remain and can promote job growth and economic opportunity.

I used to teach, as an adjunct professor, securities regulation some 10, 15 years ago, and I would teach my students that our capital markets only work to the extent that investors have faith that bad actors cannot profit off of wrongdoing. And so, that is where I want to start today.

Chairman Clayton, as you know, 2 years ago the Supreme Court ruled in *Kokesh v. SEC* that the SEC's disgorgement authority was a penalty and thus subject to a 5-year statute of limitations. The Court further hinted that the SEC may not have this authority at all.

As a result, the SEC can only bring enforcement actions involving disgorgement within 5 years of the violation, even if the SEC had no knowledge or possible way of knowing about the securities violation. And the immediate result of this case was that Charles Kokesh was able to keep \$30 million in ill-gotten gains.

But I want to go broader than just the individual case at hand. Can you talk briefly about the effects of the *Kokesh* ruling on both investors and the SEC?

Mr. CLAYTON. It is adverse for both—adverse for investors who were defrauded and adverse for the markets generally. You shouldn't be able to have somebody who conceals a fraud get to keep the money if they are really good at concealing the fraud. That doesn't make sense.

Mr. MCADAMS. That is right, bad actors face fewer consequences, investors are less protected, disgorged funds are unable to be recovered, I think, and probably more staff time and resources to fighting lawsuits from bad actors.

Mr. Chairman, as you know, I, along with my Republican colleague, Bill Huizenga,—I think Mr. Huizenga is here today—introduced the bipartisan Investor Protection and Capital Markets Fairness Act. And last week, this committee approved that legislation on a broad bipartisan basis. The bill would specifically authorize the SEC to seek disgorgement and injunctions against bad actors and give the SEC up to 14 years to pursue these actions.

Do you support this legislation? And do you believe that it would effectively address the negative effects of the *Kokesh* decision that we have discussed?

Mr. CLAYTON. As I mentioned in my opening statement, my colleagues and I, the members of the Enforcement Division, thank you for your attention to this, and we want to see a fix to the *Kokesh* issue move forward here and in the Senate. I understand there is debate about the contours, but let's get this fixed.

Mr. MCADAMS. Yes. And generally speaking, we very much appreciate—my staff appreciate working with the SEC to try and bring this fix and to bring forward legislation that can garner bipartisan support and seek to address this. And we understand that, like any piece of legislation, there is a path moving forward, and we will ultimately have to reach agreement in a bicameral fashion as well.

Generally speaking, do you see that legislation as a positive step forward to granting the Commission the authority it needs to enforce?

Mr. CLAYTON. I do.

Mr. MCADAMS. Tell me, in level of priority, how important is it to you that Congress address the *Kokesh* decision to ensure that our capital markets are fair for investors?

Mr. CLAYTON. It is a focus of all of ours that when there is wrongdoing, not only do we act quickly, not do we act decisively, but we get people their money back. And these types of frauds, Ponzi schemes, they are basically taking money right out of the pockets of ordinary investors. We talked about Stanford earlier, and those types of things. It is important to the integrity and it is just important to our citizens that we can get their money back.

Mr. MCADAMS. Thank you. And we appreciate your willingness to work with us on that and to move forward legislation.

Are there particular types of cases in which investors are vulnerable without a fix to this Court ruling?

Mr. CLAYTON. Yes, we had some discussion of Stanford earlier. It is those well-hidden schemes, particularly in our private markets, the, “Hey, you know, I have the secret sauce, don’t tell anybody,” types of situation or, “We are all friends here,” type of situations, that they are particularly vulnerable to the issue that was raised by the Supreme Court decision in *Kokesh*.

Mr. MCADAMS. Thank you.

And, Mr. Chairman, some have argued against this legislation, saying that 5 years is more than sufficient for the SEC, and that if given more time, the SEC will just pursue old or stale claims. What would your response be to that assertion?

Mr. CLAYTON. I think in the area that I just described—Stanford is a public example, but there are many private Ponzi schemes—it is not like our public company market. In the public company, you have to publish financial statements, you have audits, you have reviews, you have all of these kinds of things. It’s a different environment in the private market. And like I said, you shouldn’t reward somebody for concealing a fraud for a long time.

Mr. MCADAMS. Thank you. Thank you, Chairman Clayton.

And thank you, Madam Chairwoman.

Chairwoman WATERS. Thank you.

Without objection, a letter from Better Markets will be entered into the record.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without ob-

jection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And I thank you, and this hearing is adjourned.

[Whereupon, at 1:35 p.m., the hearing was adjourned.]



## **A P P E N D I X**

September 24, 2019

**Testimony of the U.S. Securities and Exchange Commission on**

**“Oversight of the Securities and Exchange Commission:  
Wall Street’s Cop on the Beat”**

**Before the  
U.S. House of Representatives Committee on Financial Services**

**September 24, 2019**

Chairwoman Waters, Ranking Member McHenry and Members of the Committee, thank you for the opportunity to testify before you today about the work of the U.S. Securities and Exchange Commission (SEC or Commission or agency).<sup>1</sup>

**Overview—The SEC’s Mission, People and Governance**

The SEC and its tripartite mission—to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation—are critical to the functioning of our economy and the well-being of millions of Americans. With a workforce of almost 4,400 staff in Washington and across our 11 regional offices, the SEC oversees, among other things: (1) approximately \$96 trillion in securities trading annually on U.S. equity markets; (2) the disclosures of approximately 4,300 exchange-listed public companies with an approximate aggregate market capitalization of \$33 trillion; and (3) the activities of over 26,000 registered entities and registrants including, among others, investment advisers, broker-dealers, transfer agents, securities exchanges, clearing agencies, mutual funds and exchange-traded funds (ETFs), who employ over one million people in the United States. The agency also has oversight of self-regulatory organizations (SROs) such as the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB) and the Public Company Accounting Oversight Board (PCAOB).

Across the SEC, we recognize the importance of our capital markets and our work to the global economy, the U.S. economy and millions of diverse American households. U.S. capital markets are the deepest, most dynamic and most liquid in the world. The Commission’s framework for regulation and oversight has helped achieve this by fostering a combination of investment opportunity, market confidence and investor protection, particularly in our public capital markets.

Main Street investors are the bedrock of our public capital markets. Their willingness to commit capital over the long term provides businesses with the opportunity to flourish and create jobs. Main Street investors also supply the capital markets with the funds that fuel the U.S. economy. In turn, our markets have provided retail investors with investment opportunities that help them secure their financial futures and provide for their families. At the SEC, we are motivated by the fact that tens of millions of Americans are invested in our capital markets and have to make personal investment decisions—both direct investment decisions, such as which

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<sup>1</sup> The views expressed in this testimony are those of the U.S. Securities and Exchange Commission and do not necessarily represent the views of the President.

stocks, bonds, mutual funds, ETFs and other securities to purchase or sell, and indirect investment decisions, such as whether to hire a broker-dealer or investment adviser. Many Americans also participate in our markets through pension funds and related investment vehicles.

As Commissioners, we have the privilege of serving with the SEC's dedicated staff to pursue the Commission's mission. SEC staff is most often the Commission's direct connection to investors. None of the work described in this testimony—which is only a small sample of the overall work of the staff—is possible without these talented and solutions-oriented professionals whose work, in turn, is made possible thanks to the important, often behind-the-scenes work of the agency's administrative and operations personnel. The agency's supervisors and program managers also play a critical role in ensuring effective and efficient operations and activities.

Today represents the first time since 2007 that the entire Commission has testified before Congress. It was a different time then—on the eve of the financial crisis of 2008—and our markets and even the Commission itself are now significantly different from just 12 years ago. The changes in our markets and the broader U.S. and world economies present many new challenges for the Commission and its staff to tackle. Our testimony that follows will briefly describe the actions of the agency over the past year—in terms of regulatory policy, enforcement, examinations and investor education—to address some of these issues.

A purpose of having independent commissions is to provide a diversity of experiences and views among leadership of agencies such as the SEC. While we do not always agree on matters, we are united in our shared duty to advance the Commission's mission on behalf of our investors, issuers and markets. The Commission in its 2007 testimony noted that:

...the capital markets of the United States—and now, the world—depend upon clarity and consistency in our regulatory and enforcement programs. The agency's non-partisanship has underscored that it is the rule of law, not one's political point of view, which should determine our actions. It is in this spirit that we intend to continue to tackle the significant challenges that lie ahead.<sup>2</sup>

We believe this statement captures our shared obligations well, and this Commission remains committed to maintaining a well-functioning SEC for the benefit of our economy, investors and market participants.

### **Strategic Plan**

Last fall, the Commission released its Strategic Plan for 2018-2022. The Plan provides a forward-looking framework for making the SEC more effective, focusing on the most important goals and initiatives that will best position the SEC to fulfill its mission, with the primary focus of the Plan being on investors, innovation and improved performance.<sup>3</sup> Over the past year, we have made meaningful progress toward satisfying these goals.

<sup>2</sup> Review of Investor Protection and Market Oversight with the Five Commissioners of the Securities and Exchange Commission: Hearing Before the Comm. on Financial Services, 110 Cong. 46 (2007).

<sup>3</sup> See U.S. Sec. and Exch. Comm'n Strategic Plan: Fiscal Years 2018-2022 (Oct. 2018), available at [https://www.sec.gov/files/SEC\\_Strategic\\_Plan\\_FY18-FY22\\_FINAL.pdf](https://www.sec.gov/files/SEC_Strategic_Plan_FY18-FY22_FINAL.pdf).

Our first goal is focusing on the interests of long-term Main Street investors. The past year has presented many opportunities for each of us, and SEC staff to interact directly with investors from across the country. Recently, we and SEC staff have engaged directly with a diverse group of investors through town halls, outreach tours, new digital tools and other methods. For example, in a first-of-its-kind event, on June 13, 2018, each Commissioner and SEC leadership met with more than 400 members of the public during an investor town hall at the Georgia State University College of Law in Atlanta, Georgia. This event, organized by the SEC's Office of the Investor Advocate and the Atlanta Regional Office, marked the first time in our history that the full Commission met with Main Street investors outside of Washington, D.C. The following day, the agency's Investor Advisory Committee hosted a meeting at the same location, providing another opportunity for the public to engage with the Commission. Additionally, in September 2018, four Commissioners hosted a roundtable in Baltimore, Maryland, organized by our Office of Minority and Women Inclusion and our Office of Investor Education and Advocacy (OIEA), where they heard directly from investors and spoke about the agency's efforts to enhance retail investor protection. Most recently, all five Commissioners participated in the Government-Business Forum in Omaha, Nebraska, that was organized by the SEC's new Office of the Advocate for Small Business Capital Formation.

Our second goal—to be innovative and responsive—reflects the changing nature of our markets. As technological advancements and commercial developments have changed how our securities markets operate, the SEC's ability to remain an effective regulator requires that we continually monitor the market environment and, as appropriate, adjust and modernize our expertise, rules, regulations and oversight tools and activities. This maxim drove the establishment of a Cyber Unit in the Division of Enforcement (Enforcement) in September 2017, a Fixed Income Market Structure Advisory Committee in November 2017, and more recently, our new Strategic Hub for Innovation and Financial Technology (FinHub) and our expected formation of an Asset Management Advisory Committee.

Our third goal—elevating the agency's performance through technology, data analytics and human capital—embodies our commitment to maintaining an effective and efficient operation. Maintaining a high level of staff engagement, performance and morale is critical to our ability to execute the SEC's mission.

One of the most important ways we can continually improve the SEC's operational effectiveness is by investing in our technology program, including analyzing data and promoting information sharing and collaboration across the agency. In addition, focusing on cybersecurity remains a top priority for the agency. We deeply appreciate the resources Congress provided us in fiscal years (FYs) 2018 and 2019 to help us address our technology challenges and have applied these resources to a number of key initiatives designed to strengthen our cybersecurity risk profile, including efforts to modernize legacy systems and infrastructure. We also will continue to work to better automate our business processes so we can conduct our work more efficiently in support of the SEC's mission.

### **The Commission's Fiscal Year 2019 Initiatives**

The Commission has been active in pursuing its mission over the prior fiscal year (FY 2018) and to-date in FY 2019. The following testimony summarizes the Commission's FY 2019 initiatives to date, by focusing on: (1) enforcement and compliance; (2) monitoring and addressing market developments and risks; (3) the regulatory and policy agenda, as set by Chairman Clayton; and (4) investor education initiatives.

#### **Enforcement and Compliance**

##### *Division of Enforcement*

Enforcement conducts investigations into possible violations of the federal securities laws and litigates the Commission's civil enforcement proceedings in the federal courts and in administrative proceedings. The ongoing efforts made by Enforcement to deter misconduct and punish securities law violators are critical to safeguarding millions of investors and instilling confidence in the integrity of our markets. The nature and quality of the SEC's enforcement actions—particularly the quality of these actions—during the last year speak volumes about the hard work of the agency's talented and dedicated staff.

To that end, Enforcement investigated and recommended a diverse mix of cases targeting fraud and other wrongdoing. In FY 2018, the Commission brought 821 enforcement actions and obtained judgments and orders for \$3.945 billion in penalties and disgorgement, while returning \$794 million to harmed investors and awarding nearly \$50 million in payments to whistleblowers.<sup>4</sup> These statistics demonstrate broadly the continued commitment of our Enforcement staff. However, these types of broad measures do not adequately measure the effectiveness and scope of Enforcement's work, which is better captured by the nature, quality and effects of the Commission's enforcement actions in furtherance of the agency's three-part mission.

The Commission's enforcement actions over the past two years have covered a broad range of subject areas, including investment management, securities offerings, issuer reporting and accounting, market manipulation, insider trading, broker-dealer activities, cyber-related conduct and the Foreign Corrupt Practices Act, among many others. We would like to highlight three Enforcement initiatives, in particular, for their impact on investor protection: (1) the Retail Strategy Task Force; (2) the Cyber Unit; and (3) the Share Class Selection Disclosure Initiative.

In September 2017, the SEC announced the formation of the Retail Strategy Task Force, comprised of experienced members of the Enforcement staff, to pursue two primary objectives: (1) developing data-driven, analytical strategies for identifying practices in the securities markets that harm retail investors and generating enforcement matters in these areas; and (2) collaborating with internal and external partners, such as OIEA and the Department of Justice, on retail investor advocacy and outreach. The Retail Strategy Task Force leverages enforcement resources and draws on expertise from across the Commission's divisions and

<sup>4</sup> See U.S. Sec. and Exch. Comm'n Div. of Enf. Annual Report (Nov. 2, 2018), available at <https://www.sec.gov/files/enforcement-annual-report-2018.pdf>.

offices to develop and implement strategies for addressing the types of misconduct that most affect retail investors.

Since its formation, the Retail Strategy Task Force has undertaken a number of initiatives in furtherance of its role. For example, in June 2019, the Commission announced two new initiatives to build on its ongoing efforts to protect retail investors.<sup>5</sup> The Teachers' Initiative and the Military Service Members' Initiative focus additional enforcement and investor education resources on instructing teachers, veterans and active duty military personnel on savings and investment, investment fees and expenses, retirement programs specific to educators and service members and the red flags of investment fraud. The Commission recognizes that teachers, active duty military and veterans provide a tremendous service to our country, often at great personal and financial sacrifice to themselves and their families, yet are often targeted and fall victim to securities fraud and other misconduct. These initiatives build upon the Commission's dedication to fighting fraud, educating retail investors and protecting vulnerable market participants. The Teachers' Initiative is building upon the existing Teacher Investment Outreach program, which is led by the SEC's San Francisco Regional Office. The Military Service Members' Initiative is building upon the Commission's longstanding commitment to serving active military and veterans through investor advocacy and outreach. Further, on October 3, 2019, the Retail Strategy Task Force will host a roundtable on combating elder investor fraud.<sup>6</sup> This roundtable will focus on the types of fraudulent and manipulative schemes currently targeting elder investors and explore views from a broad range of regulators and industry experts on potential steps regulators, broker-dealers, investment advisers and others can take to identify and combat elder investor fraud.

In September 2017, the SEC announced the creation of a specialized Cyber Unit within Enforcement to combat cyber-related threats to investors and our financial markets by focusing Enforcement's resources and expertise on, among others things, potential violations involving distributed ledger technology, cyber intrusions and hacking to obtain material, non-public information. The resources we have dedicated to the Cyber Unit's important work demonstrate the high priority the Commission places on cyber-related issues affecting investors and our markets. Cyber Unit staff members work closely with FinHub on cases involving distributed ledger technology and digital assets. The Commission has brought a number of cases in this area<sup>7</sup> and will continue to police these markets vigorously and take enforcement action against those who conduct fraudulent or unregistered initial coin offerings (ICOs) or engage in other actions relating to digital assets in violation of the federal securities laws. Enforcement, with leadership from the Cyber Unit, has continued to focus on cybersecurity threats to public companies and the resulting harm to investors from cyber incidents such as data breaches.

The Commission remains focused on our efforts to return funds to harmed investors as promptly as practicable. For example, Enforcement expanded its efforts to identify advisers that

<sup>5</sup> See Press Release 2019-85, SEC Announces Enforcement and Investor Education Initiatives to Protect Teachers and Military Service Members (June 3, 2019), available at <https://www.sec.gov/news/press-release/2019-85>.

<sup>6</sup> See Press Release 2019-134, SEC Retail Strategy Task Force to Host Roundtable on Combating Elder Investor Fraud (July 18, 2019), available at <https://www.sec.gov/news/press-release/2019-134>.

<sup>7</sup> See U.S. Sec. & Exch. Comm'n, Cyber Enforcement Actions, available at <https://www.sec.gov/spotlight/cybersecurity-enforcement-actions>.

did not adequately disclose conflicts as a result of their receipt of compensation in the form of 12b-1 fees through the Share Class Selection Disclosure Initiative. This approach—which centered on self-reporting and cooperation—will result in the return of over \$125 million to retail investors, and the resulting savings to retail investors from moving to the lower cost share classes will continue for years to come, which we expect will vastly exceed the initial \$125 million in savings.

The efforts of the Enforcement staff over the past year have made our capital markets a safer place for investors to put their hard-earned money to work, and Enforcement staff will continue their efforts to vigorously enforce the federal securities laws and seek to hold bad actors accountable, whether on Main Street or Wall Street.

#### *Office of Compliance Inspections and Examinations*

The SEC's Office of Compliance Inspections and Examinations (OCIE) is responsible for conducting examinations of entities registered with the SEC, including more than 13,400 investment advisers, approximately 10,000 mutual funds and ETFs, roughly 3,750 broker-dealers, about 340 transfer agents, seven active clearing agencies, 23 national securities exchanges, nearly 550 municipal advisors, FINRA, the MSRB, the Securities Investor Protection Corporation and the PCAOB, among others. The results of OCIE's examinations are used by the SEC to identify and monitor risks, improve industry practices, pursue misconduct and inform rulemaking initiatives.

OCIE's 2019 Examination Priorities reflect a continued focus on the SEC's commitment to protecting retail investors—including seniors and those saving for retirement.<sup>8</sup> In particular, OCIE has looked closely at products and services offered to retail investors, the disclosures they receive about those investments and the financial services professionals who serve them, as well as several other areas that present heightened risk, including compliance and risks in critical market infrastructure, cybersecurity and anti-money laundering programs. OCIE also publishes a number of risk alerts to inform registered firms and investors of common compliance issues to aid in the identification and correction of potentially deficient practices to better protect the interests of Main Street investors.<sup>9</sup>

During FY 2018, OCIE conducted over 3,150 examinations, an overall increase of 11 percent from FY 2017. This includes a 17 percent coverage ratio for investment advisers—which increased 13 percent from FY 2017, even as the number of registered investment advisers increased by approximately 5 percent.<sup>10</sup> Staff will continue to leverage data analysis to identify potentially problematic activities and firms as well as to determine how best to scope the examinations of those activities and firms.

<sup>8</sup> U.S. Sec. & Exch. Comm'n, Off. of Compliance Inspections and Examinations, 2019 Nat'l Exam Program Examination Priorities (Dec. 20, 2018), *available at* <https://www.sec.gov/files/OCIE%202019%20Priorities.pdf>.

<sup>9</sup> U.S. Sec. & Exch. Comm'n, Off. of Compliance Inspections and Examinations, Risk Alerts, *available at* <https://www.sec.gov/ocie>.

<sup>10</sup> Due to the government shutdown in 2019, we expect to see an impact, and likely a decline, in certain FY19 metrics as compared to prior years. As such, and as noted earlier with regard to Enforcement, we believe a purely quantitative approach to evaluating performance is insufficient.

### Monitoring and Addressing Market Developments and Risks

As our markets continue to evolve, new issues and risks often arise. Many of these issues span the responsibilities and expertise of our divisions and offices. For example, the Commission and SEC staff have been closely monitoring Brexit and its potential impacts on U.S. markets and investors, and more broadly, on global financial markets. The SEC's responsibility is primarily related to the impact of Brexit on U.S. capital markets, and the Divisions of Corporation Finance, Investment Management and Trading and Markets have been focusing on the disclosures companies and advisers make related to Brexit and the functioning of our market utilities and other infrastructure, respectively. We will continue to monitor and plan for potential Brexit-related impacts on U.S. investors and markets.

The SEC also has been focused on the transition away from LIBOR as a benchmark for short-term interest rates and the financial market risks that the transition may present. As LIBOR is used extensively in the U.S. and globally as a benchmark rate to set interest rates for various commercial and financial contracts, the discontinuation of LIBOR could have a significant impact on financial markets and may present a material risk for market participants, including public companies, exchanges, clearing agencies, investment advisers, investment companies and broker-dealers.<sup>11</sup> In July 2019, staff from multiple SEC divisions and offices published a statement encouraging market participants to proactively manage their transition away from LIBOR and outlined several potential areas that may warrant increased attention during that time.<sup>12</sup> Staff has provided guidance for how registrants might respond to risks associated with the discontinuation of LIBOR and will be actively monitoring which market participants are identifying and addressing risks associated with the expected discontinuation of LIBOR.

These are just a few of the risks to the domestic and international financial markets where the SEC has focused its attention. In recognition of the SEC's critical role in this area, earlier this year, Chairman Clayton created a new position, the Senior Policy Advisor for Market and Activities-Based Risk, to manage and coordinate a cross-disciplinary SEC staff committee that is responsible for identifying, monitoring and responding to market risks, including activities-based risks. Additionally, the SEC plays an active role and contributes to and benefits from participation in various domestic and international organizations that focus on market and systemic risks, including the Financial and Banking Information Infrastructure Committee (FBIIC), Financial Stability Board (FSB)<sup>13</sup> and the International Organization of Securities

<sup>11</sup> See SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks (Dec. 6, 2018), available at <https://www.sec.gov/news/speech/speech-clayton-120618>.

<sup>12</sup> See Press Release 2019-129, SEC Staff Publishes Statement Highlighting Risks for Market Participants to Consider As They Transition Away from LIBOR (July 12, 2019), available at <https://www.sec.gov/news/press-release/2019-129>. Note that staff guidance represents the views of the staff. It is not a rule, regulation or statement of the Commission. Furthermore, the Commission has neither approved nor disapproved its content. Staff guidance, like all staff statements, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person.

<sup>13</sup> With respect to the FSB, Chairman Clayton, Commissioners and SEC staff substantially contribute to the FSB's ongoing monitoring and assessment of vulnerabilities affecting the global financial system, in particular with regard to securities market developments and their implications for regulatory policy. Commissioner Peirce also serves as the SEC's representative on the FSB's Standing Committee on Assessment of Vulnerabilities (SCAV), which focuses on vulnerabilities and risks arising from structural weaknesses in the financial system.

Commissions (IOSCO). The Chairman is a member of the Financial Stability Oversight Council (FSOC). In addition to engagement with these and other organizations, we also directly coordinate and share information and observations on almost a daily basis with our domestic regulatory counterparts at the Treasury Department, the Commodity Futures Trading Commission (CFTC) and the Federal Reserve, among others.

In conjunction with our fellow regulators at these and other organizations, we are also monitoring issues in other areas such as: (1) leveraged lending (including funds and products that invest in leveraged loans); (2) central clearing (including issues related to capital, redundancy and resilience); (3) governmental actions (including monetary and trade policy); (4) cybersecurity and data integrity (including identifying and assessing mission-critical systems); and (5) financial stability matters, more generally.

One notable, new area of focus where interdivisional work is essential is in the digital asset and ICO space. We have strived to achieve a regulatory approach that both fosters innovation and protects investors. SEC staff also meets regularly with staff from other regulatory agencies—domestic and international—to coordinate efforts and identify any areas where additional regulatory oversight may be needed. In an effort to further coordinate the Commission's work on these important issues, in October 2018, the SEC announced the formation of FinHub within the agency.<sup>14</sup> Staffed by representatives from across the Commission, FinHub is intended to serve as a public resource for FinTech-related issues at the SEC, including matters dealing with distributed ledger technology (DLT), automated investment advice, digital marketplace financing and artificial intelligence/machine learning. In May 2019, FinHub hosted a public FinTech forum focusing on DLT and digital assets and explored topics such as ICOs, digital asset platforms, DLT innovations and how these technologies impact investors and the markets.

In addition to serving as a portal for public engagement, FinHub also serves as an internal resource within the SEC, coordinating the staff's work on FinTech-related issues. As the work of FinHub and our other activities demonstrate, the agency is focused on issues presented by new technologies, and our door remains open to those who seek to innovate and raise capital in accordance with the federal securities laws and consistent with important investor protections.<sup>15</sup>

#### *Cybersecurity and Information Technology at the Commission*

Focusing on cybersecurity risk remains a top priority for the SEC. The SEC and other agencies are frequent targets of attempts by threat actors who seek to penetrate our systems, and some of those actors may be backed by substantial resources. We recognize that electronic data systems are essential to our mission and that no system can ever be entirely safe from a cyber intrusion, but it is incumbent upon us to continue to devote substantial resources and attention to cybersecurity, including the protection of personally identifiable information (PII). It is clear that the Commission's efforts in the areas of cybersecurity, systems resilience and risk

<sup>14</sup> See Press Release 2018-240, SEC Launches New Strategic Hub for Innovation and Financial Technology (Oct. 18, 2018), available at <https://www.sec.gov/news/press-release/2018-240>.

<sup>15</sup> For example, FinHub recently released a framework for investment contract analysis for digital assets. Additionally, along with FINRA, the Division of Trading and Markets in coordination with FinHub also recently released guidance relating to custody of digital assets.

management were in need of improvement. Over the past year, the Commission has been focused on a number of areas for improvement, including information technology (IT) governance and oversight, security controls, risk awareness related to sensitive data, incident response and reliance on legacy systems. While progress has been made, much work remains to be done. We continue to value the insights and assistance from our audit partners at the Office of Inspector General and the Government Accountability Office and have been working diligently to implement their recommendations.

A key principle in our review of the SEC's cybersecurity and enterprise risk profiles is to evaluate the data we take in, assess our regulatory and enforcement responsibilities and limit the scope of that information to what is necessary to achieve those responsibilities. In particular, we are closely scrutinizing how we can reduce any potential exposure of PII contained in SEC systems, including EDGAR. For example, last year the Commission acted to eliminate the collection of social security numbers and dates of birth on a number of EDGAR forms where we concluded that the information was not necessary to our mission. Additionally, the Commission implemented modified submission deadlines for filing non-public reports for registered investment companies that will allow the agency to receive and analyze the data while meaningfully reducing the sensitivity of that data at the time it is transmitted.

We will continue efforts to assess our data footprint, with the help of a soon-to-be-hired Chief Data Officer. Required of all federal agencies by statute, this new position, among other duties, will help us improve our review process over data collection to provide greater assurance that we collect only the data we need to fulfill our mission and can effectively manage and secure.

The agency also has focused closely on its cybersecurity risk governance structure. This year, the SEC hired a Chief Risk Officer to help coordinate our enterprise risk management efforts across the agency. We have worked to promote a culture that emphasizes the importance of data security and operational resilience throughout our divisions and offices. The staff also has been engaging with outside experts to assess and improve our security controls. For example, on a technical level, these efforts include the deployment of enhanced security capabilities, additional penetration testing and code reviews, investment in new technologies and transition of legacy systems to modern platforms. We also will continue to coordinate and partner with other federal agencies to identify and mitigate risks to our IT environment and assets.

Other priority IT initiatives on which the SEC is focused include: (1) continuing the modernization and development of a more secure EDGAR filing system; (2) deploying enhancements to critical analytic systems and upgrading the agency's electronic discovery and document management tools; (3) digitizing business processes so SEC staff can be more efficient and focus more of their time on higher-order analyses in pursuit of our mission; and (4) retiring legacy SEC systems and applications in favor of modernized, more secure replacements with lower costs.

A key element in advancing this ambitious agenda to improve and secure our technology environment is to attract and retain robust technology and cyber talent, especially given the often

fierce competition to recruit these individuals. We have grown our IT workforce by 15 percent and our IT security staff positions by over 75 percent since 2017, and we will continue to focus on recruiting talented individuals to maintain a strong IT workforce at the SEC.

## **Regulatory and Policy Agenda**

### *Division of Corporation Finance*

The Division of Corporation Finance (Corporation Finance) seeks to ensure that investors are provided with the material information they need to make informed investment decisions, both when a company initially offers its securities to the public and on an ongoing basis as it continues to provide information to the marketplace. Since 2017, Corporation Finance has undertaken a number of initiatives to further these regulatory goals.

The Commission has also taken several steps aimed at helping companies—including smaller companies—participate in our capital markets. Many of these actions build upon the initiatives embodied in the Jumpstart our Business Startups (JOBS) Act.<sup>16</sup> For example, in May 2019, the Commission proposed amendments to the “accelerated filer” and “large accelerated filer” definitions.<sup>17</sup> Under the proposed amendments, smaller reporting companies with less than \$100 million in revenues would not be required to obtain an attestation of their internal control over financial reporting from an independent outside auditor. For many smaller companies that received a similar five-year exemption under the JOBS Act, this proposal would extend that exemption until the company exceeded \$100 million in revenues. SEC staff is reviewing public comments received on the proposal. Further, in February 2019, the Commission proposed amendments to expand the “test-the-waters” accommodation to all issuers, allowing them to gauge market interest in a possible IPO or other proposed registered securities offering by permitting discussions with certain investors prior to the filing of a registration statement.<sup>18</sup> Additionally, in December 2018, the Commission adopted final rules providing flexibility to reporting companies when raising capital to allow them to rely on the Regulation A exemption from registration, as required by the Economic Growth, Regulatory Relief, and Consumer Protection Act.<sup>19</sup>

We are also considering how to improve our private markets for investors and issuers. Our private markets have become increasingly important, and unlike twenty-five years ago, today outpace the public markets in many measures, including in size. Unless one is an

<sup>16</sup> Pub. L. No. 112-106 (2012).

<sup>17</sup> See Press Release 2019-68, SEC Proposes Amendments to More Appropriately Tailor the Accelerated and Large Accelerated Filer Definitions (May 9, 2019), available at <https://www.sec.gov/news/press-release/2019-68>. This proposal followed the Commission adopting amendments to expand the definition of “smaller reporting company” to increase the number of companies that qualify for scaled disclosure accommodations in June 2018. See Press Release 2018-116, SEC Expands the Scope of Smaller Public Companies that Qualify for Scaled Disclosures (June 28, 2018), available at <https://www.sec.gov/news/press-release/2018-116>.

<sup>18</sup> See Press Release 2019-14, SEC Proposes to Expand “Test-the-Waters” Modernization Reform to All Issuers (Feb. 19, 2019), available at <https://www.sec.gov/news/press-release/2019-14>.

<sup>19</sup> See Press Release 2018-297, SEC Adopts Final Rules to Allow Exchange Act Reporting Companies to Use Regulation A (Dec. 19, 2018), available at <https://www.sec.gov/news/press-release/2018-297>.

accredited investor, the options in the private markets are limited. In June 2019, the Commission issued a concept release that seeks comment on possible ways to simplify, harmonize and improve the exempt offering framework to expand investment opportunities while enhancing appropriate investor protections and promoting capital formation.<sup>20</sup> The concept release seeks input on whether changes should be made to improve the consistency, accessibility and effectiveness of the Commission's exemptions for both companies and investors, including identifying potential overlap or gaps within the framework and identifying additional investor protections. SEC staff is reviewing comments received on the release, and we look forward to their recommendations.

The Commission also has taken a number of actions to update disclosure requirements in an effort to enhance the quality of information available to investors and reduce costs for registrants.<sup>21</sup> For example, in March 2019, the Commission adopted amendments to modernize and simplify disclosure requirements for public companies, investment advisers and investment companies, consistent with its congressional mandate under the Fixing America's Surface Transportation (FAST) Act.<sup>22</sup> The amendments, among other things, increase flexibility in the discussion of historical periods in Management's Discussion and Analysis (MD&A) and allow companies to redact confidential information from most exhibits without filing a confidential treatment request. More recently, the Commission proposed rule amendments to modernize the description of business, legal proceedings and risk factor disclosures under Regulation S-K.<sup>23</sup> We expect efforts to modernize, improve and simplify disclosure requirements to continue in the coming year.

To help promote more robust disclosure by companies about cybersecurity risks and incidents, in February 2018, the Commission approved a statement and interpretive guidance that discusses public companies' disclosure obligations under existing law with respect to matters involving cybersecurity risk and incidents. The Commission also addressed the importance of cybersecurity policies and procedures that enable public companies to make accurate and timely disclosures about material cybersecurity events, as well as policies that protect against corporate insiders trading in advance of company disclosures of material cyber incidents.<sup>24</sup>

Additionally, in December 2018, the Commission adopted rules pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to require companies

<sup>20</sup> See Press Release 2019-97, SEC Seeks Public Comment on Ways to Harmonize Private Securities Offering Exemptions (June 18, 2019), available at <https://www.sec.gov/news/press-release/2019-97>.

<sup>21</sup> See, e.g., Press Release 2019-65, SEC Proposes to Improve Disclosures Relating to Acquisitions and Dispositions of Businesses (May 3, 2019), available at <https://www.sec.gov/news/press-release/2019-123>, <https://www.sec.gov/news/press-release/2019-65>; Press Release 2018-156, SEC Adopts Amendments to Simplify and Update Disclosure Requirements (Aug. 17, 2018), available at <https://www.sec.gov/news/press-release/2018-156>.

<sup>22</sup> See Press Release 2019-38, SEC Adopts Rules to Implement FAST Act Mandate to Modernize and Simplify Disclosure (Mar. 20, 2019), available at <https://www.sec.gov/news/press-release/2019-38>.

<sup>23</sup> See Press Release 2019-148, SEC Proposed to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K (Aug. 8, 2019), available at <https://www.sec.gov/news/press-release/2019-148>.

<sup>24</sup> See Press Release 2018-22, SEC Adopts Statement and Interpretive Guidance on Public Company Cybersecurity Disclosures (Feb. 21, 2018), available at <https://www.sec.gov/news/press-release/2018-22>.

to disclose in proxy or information statements for the election of directors any practices or policies regarding the ability of employees or directors to engage in certain hedging transactions with respect to company equity securities.<sup>25</sup> We expect the staff to provide recommendations for Commission consideration on other mandated compensation rules, including an interagency rulemaking on incentive compensation required by Section 956 of the Dodd-Frank Act.

Another issue under consideration is how to foster a longer-term performance perspective in American companies for the benefit of Main Street investors who are increasingly responsible for funding their own retirement and other financial needs. In December 2018, the Commission published a request for comment soliciting input on the nature, content and timing of earnings releases and quarterly reports made by reporting companies and specifically asked for comments on whether, and if so, how our reporting system may be contributing to a disproportionate focus on short-term results.<sup>26</sup> In July 2019, SEC staff held a roundtable to hear the diverse viewpoints of investors, issuers and other market participants on these issues.<sup>27</sup> The comment file remains open, and we look forward to continued public engagement on these issues.

#### *Division of Investment Management*

The Division of Investment Management (Investment Management) has primary responsibility for administering the Investment Company Act of 1940 and Investment Advisers Act of 1940. This involves developing regulatory policy for investment advisers and for investment companies, including mutual funds, money market funds, closed-end funds, business development companies (BDCs), unit investment trusts, variable insurance products and ETFs.

Investment Management is leading a long-term project to explore modernization of the design, delivery and content of fund disclosures and other information for the benefit of investors. These initiatives are an important part of how the Commission can serve investors in the 21st century. Fund disclosures are especially important because millions of Americans invest in funds to help them achieve personal financial goals, such as saving for retirement and their children's educations. As of the end of 2018, over 100 million individuals representing nearly 57 million households, or 45 percent of U.S. households, owned funds (generally ETFs or open-ended mutual funds).<sup>28</sup>

In June 2018, the Commission issued a request for comment on enhancing disclosures by mutual funds, ETFs and other types of investment companies to improve the investor experience and to help investors make more informed investment decisions (Fund Disclosure RFC).<sup>29</sup> The

<sup>25</sup> See Press Release 2018-291, SEC Adopts Final Rules for Disclosure of Hedging Policies (Dec. 18, 2018), available at <https://www.sec.gov/news/press-release/2018-291>.

<sup>26</sup> See Press Release 2018-287, SEC Solicits Public Comment on Earnings Releases and Quarterly Reports (Dec. 18, 2018), available at <https://www.sec.gov/news/press-release/2018-287>.

<sup>27</sup> See July 18, 2019 Roundtable on Short-Term / Long-Term Management of Public Companies, Our Periodic Reporting System and Regulatory Requirements, available at <https://www.sec.gov/spotlight/short-and-long-term-management-public-companies-roundtable>.

<sup>28</sup> Investment Company Institute, 2019 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry, 2, 59th ed. 2019.

<sup>29</sup> See Press Release 2018-103, SEC Modernizes the Delivery of Fund Reports and Seeks Public Feedback on Improving Fund Disclosure (June 5, 2018), available at <https://www.sec.gov/news/press-release/2018-103>.

Fund Disclosure RFC seeks input from retail investors and others on how they use fund disclosures and how they believe funds can improve disclosures to aid investment decision-making. In order to facilitate retail investor engagement and comment on improving fund disclosure, the Commission has provided a short Feedback Flier on Improving Fund Disclosure, which can be viewed and submitted at [www.sec.gov/tell-us](http://www.sec.gov/tell-us). The Commission also adopted a new rule that creates an optional “notice and access” method for delivering fund shareholder reports.<sup>30</sup> The reforms include protections for those without internet access or who simply prefer paper by preserving the ability to continue to receive reports in paper.

In 2018, the Commission proposed a new rule and form amendments intended to modernize the regulatory framework for ETFs, by establishing a clear and consistent framework for the vast majority of ETFs operating today.<sup>31</sup> Since 1992, the Commission has issued more than 300 exemptive orders allowing ETFs to operate under the Investment Company Act. Under the rulemaking proposal, ETFs that satisfy certain conditions would be able to operate within the scope of the Investment Company Act and come to market without applying for individual exemptive orders.

In response to congressional directives, in November 2018, the Commission adopted rules and amendments designed to promote research on mutual funds, ETFs, registered closed-end funds, BDCs and similar covered investment funds.<sup>32</sup> These changes are intended to reduce obstacles to providing research on investment funds by harmonizing the treatment of such research with research on other public companies. Additionally, consistent with congressional mandates under the Small Business Credit Availability Act and the Economic Growth, Regulatory Relief, and Consumer Protection Act, the Commission proposed rule and form amendments to modernize the offerings of BDCs and registered closed-end funds.<sup>33</sup> Specifically, the proposed amendments would modify the registration, communications and offering processes available to BDCs and registered closed-end funds, building on offering practices that operating companies currently use. Staff is reviewing the public comments received as it considers recommendations for final rules.

In addition, the Commission is working to form an Asset Management Advisory Committee. Over the last two decades, major trends in retirement funding, investment philosophies, technology and capital formation have driven changes that include increased assets, new products, new strategies and new challenges in the environment for investors and investment managers. For example, there are now over 13,000 SEC-registered investment advisers with over \$84 trillion in assets under management, and over 8,000 of these investment advisers provide services to retail investors. The emergence of index investing and ETFs has changed the way many investors build their portfolios and helped spark new rounds of competition over fees. Increased globalization has also intertwined domestic and foreign

<sup>30</sup> *Id.*

<sup>31</sup> See Press Release 2018-118, SEC Proposes New Approval Process for Certain Exchange-Traded Funds (June, 28, 2018), available at <https://www.sec.gov/news/press-release/2018-118>.

<sup>32</sup> See Press Release 2018-269, SEC Adopts FAIR Act Rules Promoting Research Reports on Investment Funds (Nov. 30, 2018), available at <https://www.sec.gov/news/press-release/2018-269>.

<sup>33</sup> See Press Release 2019-39, SEC Proposes Offering Reforms for Business Development Companies and Closed-End Investment Funds (March 20, 2019), available at <https://www.sec.gov/news/press-release/2019-39>; see also Pub. L. 115-141, 132 Stat. 348 (2018); Pub. L. 115-174, 132 Stat. 1296 (2018).

markets and policy. Financial regulators and the public could benefit from thoughtful discussion among experts with diverse viewpoints on these issues, and the Commission is well-positioned to host that discussion. An advisory committee could lend transparency, engagement and rigor to the public discourse on these issues.

#### *Division of Trading and Markets*

Another area of focus for the Commission is helping to ensure fair and efficient trading markets for our Main Street investors. The Division of Trading and Markets (Trading and Markets) regulates the major securities markets participants, including broker-dealers, SROs (such as stock exchanges, FINRA and clearing agencies) and transfer agents. This is an area where technology and other factors have driven substantial change, domestically and globally, and we need to adjust our regulation and oversight accordingly.

The Commission has taken significant steps to make our modern, electronic-driven trading markets more transparent. For instance, Trading and Markets has been focused on considering potential steps to improve Regulation NMS, which is the primary regulation governing equity market structure. It was designed to address equity market structure challenges that were prevalent over a decade ago, and until recently, it remained largely untouched since first adopted in 2005. Last year, the Commission adopted three rules affecting equity market structure, including: (1) new Rule 610T of Regulation NMS to conduct a Transaction Fee Pilot in NMS stocks;<sup>34</sup> (2) amendments to require broker-dealers to disclose to investors new and enhanced information about the way they handle investors' orders in NMS stocks;<sup>35</sup> and (3) amendments to Regulation ATS to enhance operational transparency and regulatory oversight of alternative trading systems that trade NMS stocks.<sup>36</sup>

In 2018, Trading and Markets held numerous public roundtables at which the Commission and SEC staff engaged in an open forum with market participants and other interested constituencies on some of the most salient issues affecting our markets today. At the public roundtables, the Commission and SEC staff heard from investors and other market participants on their concerns about the current U.S. equity market structure. These roundtables covered topics such as market structure for thinly-traded securities for both equities and exchange-traded products;<sup>37</sup> regulatory approaches to combating retail investor fraud;<sup>38</sup> and market data and market access.<sup>39</sup> The quality of our markets for thinly-traded securities is an area where further review may be needed. Trading and Markets staff is exploring the issue of

<sup>34</sup> See Press Release 2018-298, SEC Adopts Transaction Fee Pilot for NMS Stocks (Dec. 19, 2018), *available at* <https://www.sec.gov/news/press-release/2018-298>.

<sup>35</sup> See Press Release 2018-253, SEC Adopts Rules That Increase Information Brokers Must Provide to Investors on Order Handling (Nov. 2, 2018), *available at* <https://www.sec.gov/news/press-release/2018-253>.

<sup>36</sup> See Press Release 2018-136, SEC Adopts Rules to Enhance Transparency and Oversight of Alternative Trading Systems (July 18, 2018), *available at* <https://www.sec.gov/news/press-release/2018-136>.

<sup>37</sup> See Press Release 2018-65, SEC Staff to Host Roundtable on Market Structure for Thinly-Traded Securities (April 13, 2018), *available at* <https://www.sec.gov/news/press-release/2018-65>.

<sup>38</sup> See Press Release 2018-200, SEC Staff to Host Roundtable on Regulatory Approaches to Combating Retail Investor Fraud (Sept. 18, 2018), *available at* <https://www.sec.gov/news/press-release/2018-200>.

<sup>39</sup> See Press Release 118-210, SEC Staff to Host Roundtable on Market Data and Market Access (Sept. 24, 2018), *available at* <https://www.investor.gov/additional-resources/news-alerts/press-releases/sec-staff-host-roundtable-market-data-market-access>.

primary listing exchanges potentially developing innovative market structure solutions that could address certain issues regarding thinly-traded securities.

In addition, the Commission is evaluating the effectiveness of Rule 15c2-11, which mandates what actions broker-dealers must take prior to publishing quotations for securities that do not trade on a national securities exchange. This Rule, which was introduced before it was commonplace to distribute reports and other materials electronically (including through webpages and e-mail), includes a number of exceptions that permit broker-dealers to publish quotations without conducting the review otherwise required by the Rule. In particular, the piggyback exception, which allows broker-dealers to publish quotations of securities that are regularly quoted, may result in retail investors having little or no relevant information about a company. This lack of current and publicly available information about a company may particularly disadvantage retail investors in making informed choices. To this end, the Commission is considering ways to make Rule 15c2-11 more effective at protecting retail investors from incidents of fraud and manipulation in over-the-counter (OTC) securities—particularly the securities of issuers without information that is current and publicly available—and to appropriately tailor the Rule to be more efficient and effective. Staff continues to develop recommendations to address some of the other issues identified at these roundtables.

Our fixed income markets are also critical to our economy and Main Street investors, though historically, they have garnered less attention relative to the equity markets. In November 2017, the SEC created the Fixed Income Market Structure Advisory Committee (FIMSAC) to provide diverse perspectives on the structure and operations of the U.S. fixed income markets, as well as advice and recommendations on fixed income market structure. To date, FIMSAC has held seven meetings and has provided the Commission with ten thoughtful recommendations on ways to improve our fixed income markets.<sup>40</sup>

Additionally, the Commission has continued to make progress toward establishing the Dodd-Frank Act's Title VII regulatory regime. In particular, the Commission finalized Rule of Practice 194 to create a transparent, efficient and comprehensive process for application to the Commission for relief from the statutory disqualification prohibition.<sup>41</sup> The Commission also adopted capital, margin and segregation rules intended to help ensure the safety and soundness of firms that stand at the center of our security-based swap market and to protect their counterparties and reduce risk to the market as a whole. Finally, the Commission has proposed rules and interpretative guidance intended to improve the framework for regulating cross-border security-based swap transactions and market participants, as well as a rule to apply risk mitigation techniques to portfolios of uncleared security-based swaps.<sup>42</sup> In the coming year, the

<sup>40</sup> See Fixed Income Market Structure Advisory Committee, available at <https://www.sec.gov/spotlight/fixed-income-advisory-committee>.

<sup>41</sup> See Press Release 2019-293, SEC Adopts Rule of Practice 194 (Dec. 19, 2018), available at <https://www.sec.gov/news/press-release/2018-293>.

<sup>42</sup> See Press Release 2019-69, SEC Proposes Actions to Improve Cross-Border Application of Security-Based Swap Requirements (May 10, 2019), available at <https://www.sec.gov/news/press-release/2019-69>.

Commission anticipates completing consideration of these pending security-based swap rulemakings under Title VII.<sup>43</sup>

As part of this effort, SEC staff has been actively engaged with our counterparts at the CFTC to explore ways to further harmonize the Commission's security-based swap rules with the swap rules developed by the CFTC to increase effectiveness and reduce complexity and costs. To further this cooperation, the SEC and CFTC executed a memorandum of understanding (MOU),<sup>44</sup> which explicitly acknowledges shared regulatory interests between the agencies—including, but not limited to, Title VII—and reconfirms our commitment to work together to facilitate efficient markets for the benefit of all market participants.

In addition to continued discussions with the CFTC regarding Title VII harmonization, the Commission and staff have engaged with our fellow financial regulators to address other issues in our combined markets in a consistent manner. With respect to the Volcker Rule, the Commission, jointly with the other federal financial regulators, adopted a final rule to exclude community banks from the Volcker Rule, consistent with the Economic Growth, Regulatory Relief, and Consumer Protection Act.<sup>45</sup> The final rule also permits a hedge fund or private equity fund, under certain circumstances, to share the same name or a variation of the same name with an investment adviser as long as the adviser is not an insured depository institution, a company that controls an insured depository institution, or a bank holding company.

The Commission and the staff are also working with the SROs on the implementation of the Consolidated Audit Trail (CAT). The CAT is designed to provide a single, comprehensive database that, when fully implemented, should allow regulators to more efficiently and accurately track and monitor trading in equities and options throughout the U.S. markets. Among other things, the CAT is intended to allow the Commission to better carry out its market oversight responsibility by improving our ability to reconstruct trading activity following a market disruption or other event, which in turn would allow us to more quickly understand the causes of such an event and respond appropriately. In addition, the ability to better reconstruct trading activity would allow SROs and the Commission to better identify and address illicit market behavior. Under the CAT NMS Plan, the SROs—the national securities exchanges and FINRA—are responsible for developing and implementing the CAT. They were required to begin reporting data to the CAT by November 15, 2017, but they did not begin reporting by that deadline.

While the SROs are making progress and have begun reporting SRO transaction data, the remaining CAT functionality required under the CAT NMS Plan is being implemented in phases. To reduce the likelihood of further unnecessary or unanticipated delays and to increase the transparency of the implementation process for market participants who must bring their systems into compliance for reporting to the CAT, the Commission recently proposed amendments to the

<sup>43</sup> See Agency Rule List-Spring 2019, U.S. Sec. and Exch. Comm'n, *available at* [https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION\\_GET\\_AGENCY\\_RULE\\_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235](https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235).

<sup>44</sup> See Press Release 2018-114, SEC and CFTC Announce Approval of New MOU (June 28, 2018), *available at* <https://www.sec.gov/news/press-release/2018-114>.

<sup>45</sup> See Press Release 2019-124, Agencies Adopt Final Rule to Exclude Community Banks from the Volcker Rule (July 9, 2019), *available at* <https://www.sec.gov/news/pressrelease/2019-124>.

national market system plan governing the CAT.<sup>46</sup> These proposed amendments would require the SROs to file with the Commission and to make publicly available an implementation plan and quarterly status reports. The proposed amendments also would establish provisions that are designed to introduce financial accountability and promote senior management attention to implementation in order to help ensure the SROs meet certain CAT implementation milestones in a timely fashion.

The Commission is aware of concerns surrounding CAT, most notably regarding the protection of investors' PII that would be stored in the CAT. The Commission shares these concerns and continues to make the protection of CAT data—particularly any form of PII—a top priority. The SROs have announced that, working with industry experts, they are moving forward with an approach to identifying customers where social security numbers will not be maintained by the CAT but will be hashed or masked. Further, SEC staff is considering recommending to the Commission additional amendments to the CAT NMS Plan regarding data security enhancements. Finally, as Chairman Clayton has noted, the SEC will not retrieve sensitive PII from the CAT unless it has a regulatory need for the information and believes appropriate protections to safeguard the information are in place.

#### *Standards of Conduct for Investment Professionals*

The Commission recently adopted a package of rulemakings and interpretations regarding retail investors' relationships with SEC-registered investment advisers and broker-dealers. Specifically, these actions include new Regulation Best Interest, the new Form CRS Relationship Summary (Form CRS) and two separate interpretations under the Investment Advisers Act of 1940 (Advisers Act).<sup>47</sup> While all members of the Commission do not agree with all aspects of these rules and interpretations, there is general agreement that it was past time for the Commission to act in this space, particularly as more and more Americans are responsible for their retirement savings.

Regulation Best Interest requires broker-dealers to act in the best interest of a retail customer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer. Regulation Best Interest is designed to enhance the broker-dealer standard of conduct beyond existing suitability obligations and make it clear that a broker-dealer may not put its financial interests ahead of the interests of a retail customer when making recommendations. Among other features, Regulation Best Interest expressly applies to account recommendations, which includes recommendations to roll over or transfer assets in a workplace retirement plan account to an IRA, recommendations to open a particular securities account (such as a brokerage account or advisory account) and recommendations to take a plan distribution for the purpose of opening a securities account. These recommendations are often provided at critical moments (such as at retirement) and may be irrevocable, can involve a substantial portion of a retail investor's net worth and can have significant long-term impacts.

<sup>46</sup> See Press Release 2019-173, SEC Proposes Transparency and Financial Accountability Amendments to the CAT NMS Plan (Sept. 9, 2019), available at <https://www.sec.gov/news/press-release/2019-173>.

<sup>47</sup> See Press Release 2019-89, SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Financial Professionals (June 5, 2019), available at <https://www.sec.gov/news/press-release/2019-89>.

Form CRS will require investment advisers and broker-dealers to provide retail investors with streamlined information to aid them in understanding the nature of their relationship with their financial professional. Form CRS will also include a link to a dedicated page on the Commission's investor education website, Investor.gov, which offers educational information about broker-dealers and investment advisers, and other materials.

The Commission also issued an interpretation of the fiduciary duty that investment advisers owe to their clients under the Advisers Act. Finally, the Commission issued an interpretation of the "solely incidental" prong of the broker-dealer exclusion under the Advisers Act, which is intended to delineate more clearly when a broker-dealer's performance of advisory activities causes it to become an investment adviser within the meaning of the Advisers Act.

In connection with the rulemaking, the SEC launched a Main Street investor education campaign designed to help retail investors understand key differences between broker-dealers and investment advisers and to help them decide whether working with one of these types of financial professionals is right for them. Features of this campaign include short, educational videos designed to provide ordinary investors with basic information about investment professionals that are available on Investor.gov,<sup>48</sup> as well as a series of retail investor events.<sup>49</sup>

#### *Proxy Process Improvements*

Another initiative for 2019 is improving the proxy process. In November 2018, SEC staff held a proxy roundtable to discuss: (1) the proxy solicitation and voting process; (2) shareholder engagement through the shareholder proposal process; and (3) the role of proxy advisory firms.<sup>50</sup> Given the overall complexity of the proxy "plumbing" underlying the proxy voting system, SEC staff continues to encourage input from market participants to identify actionable, interim improvements to the current system. Recently, the Commission issued guidance related to investment advisers' fiduciary duties in fulfilling their proxy voting responsibilities, particularly where they use the services of a proxy advisory firm. On the same date, the Commission issued an interpretation that voting advice provided by a proxy advisory firm generally constitutes a "solicitation" under the federal proxy rules and provided related guidance about the application of the proxy antifraud rule to proxy voting advice.<sup>51</sup> SEC staff also is developing recommendations regarding the ownership and resubmission thresholds for shareholder proposals, as well as the proxy solicitation exemptions relied on by proxy advisory firms for the Commission's consideration.

<sup>48</sup> See Investor.gov; see also Press Release 2019-153, SEC Releases Videos for Investors on Choosing and Working with a Financial Professional (Aug. 15, 2019), available at <https://www.sec.gov/news/press-release/2019-153>.

<sup>49</sup> See Press Release 2019-144, SEC Chairman Clayton Announces Events for Main Street Investors in Chicago (Aug. 5, 2019), available at <https://www.sec.gov/news/pressrelease/2019-144>; see also Press Release 2019-100, SEC Chairman Clayton Announces Events for Main Street Investors in Boston (June 19, 2019), available at <https://www.sec.gov/news/press-release/2019-100>.

<sup>50</sup> See November 15, 2018: Roundtable on the Proxy Process, available at <https://www.sec.gov/proxy-roundtable-2018>.

<sup>51</sup> See Press Release 2019-158, SEC Clarifies Investment Advisers' Proxy Voting Responsibilities and Application of Proxy Rules to Voting Advice (Aug. 21, 2019), available at <https://www.sec.gov/news/press-release/2019-158>.

### **Investor Education Initiatives**

The SEC promotes informed investment decision-making through education initiatives aimed at providing the investing public with a better understanding of our capital markets and the opportunities and risks associated with the array of investment choices presented to them. OIEA spearheads these efforts, and participation extends throughout our divisions and offices.

The SEC's investor education platform covers a wide variety of subjects and uses multiple communication channels, including in-person outreach and use of social and digital communication. OIEA is continuing its "Before You Invest, Investor.gov" public service campaign focused on empowering retail investors through information and education, including raising awareness about Investor.gov and helping individuals protect themselves from investment fraud. OIEA, in conjunction with SEC regional offices, expects to participate in over 500 in-person outreach events in FY 2019, including events for senior citizens, military personnel, younger investors and other affinity groups. OIEA frequently works with others outside the agency to facilitate access to the information investors need to make informed investment decisions.

As part of these efforts, the staff would welcome an opportunity to work with your offices to conduct nonpartisan, public outreach events for investors. The SEC regularly conducts outreach events involving older Americans and college and high school students, as well as members of the military. SEC staff frequently speaks with the public in various locations, including community centers and libraries, and OIEA has programs for investors that can be delivered locally. If such programs would be of interest, the Office of Legislative and Intergovernmental Affairs and OIEA can work with your staff to tailor a presentation to the needs of the audience.

In addition to in-person outreach, the OIEA develops informative, innovative and accessible educational initiatives. Last year, for example, we created a website to educate the public about frauds involving ICOs and just how easy it is for bad actors to engineer this type of fraud—our HoweyCoins.com mock website promoted a fictional ICO. The website was created in-house, very quickly and with few resources. It attracted over 100,000 people within its first week. The SEC also published a variety of investor alerts and bulletins to warn retail investors about other possible schemes and risks for fraud, including certain investment schemes that use celebrity endorsements, self-directed individual retirement accounts, the risks in using credit cards to purchase an investment and the potential harm resulting from sharing their personal contact information with online investment promoters.

### **Conclusion**

Thank you for the opportunity to testify today and for the Committee's continued support of the SEC, its mission and its people. The Commission looks forward to working with each of you to advance our mission to the benefit of investors and our capital markets.

**Chairwoman Maxine Waters**  
**Questions for the Record**  
**House Committee on Financial Services**  
**Hearing: Oversight of the Securities and Exchange Commission:**  
**Wall Street's Cop on the Beat**  
**September 24, 2019**

**Chairman Clayton**

- 1. The SEC's effort to increase the opportunities for working-class Americans to save for their retirement are greatly appreciated. Recognizing that the main savings vehicle for most Americans is their 401(k) plan, what steps do you think the SEC and other regulators can take beyond the existing harmonization efforts to enhance the opportunities available to 401(k) plan participants, such as private funds and similar vehicles, to help maximize their security for retirement?**

**Answer:**

Until about 25 years ago, the U.S. public markets dominated the private markets in virtually every measure. Today, in many measures, the domestic private markets outpace the public markets, including in aggregate size. One problem with this dynamic is that Main Street investors, including those savings for retirement through their 401(k) plan, generally have access to only public markets— both in the U.S. and, increasingly, internationally (mostly through products). They have extremely limited, and in many cases costly and otherwise less attractive, access to our private markets. Investors without access to the private markets are limited in their ability to diversify their portfolios and, as companies stay private longer, investors can lose out on opportunities to participate in company growth and earn a return on investment. This issue is increasingly significant because of changes in the ways that people are saving for retirement. As you know, defined benefit plans, or pension plans, are far less common for today's generation of workers than they were in prior decades. Instead, they have been replaced by defined contribution plans that generally do not have options for their participants to invest in the private markets the way that pension plan custodians can.

Examining whether there are ways to facilitate Main Street Investors' access to private markets is a priority of mine. In March, the Commission proposed a set of amendments that would harmonize, simplify and improve the exempt offering framework. The proposed amendments seek to promote capital formation and expand investment opportunities while preserving and enhancing investor protections. The recommendations were informed by feedback we received on a concept release the Commission issued last in June 2019, seeking public comment on ways to harmonize the overall framework for exempt securities offerings, which included a discussion of retail investor access to pooled investment funds that invest in exempt offerings. The proposed amendments are centered on small and medium-sized companies and seek to address the gaps and complexities in the offering framework that may impede access to capital for these issuers.

We have received many thoughtful comments from the public on the concept release overall, including several addressing specifically the Commission's rules and requirements that may affect 401(k) plan participants' exposure to the private capital markets. The staff and I will continue to explore possible steps to facilitate greater 401(k) plan participant access to private investments through appropriately structured funds—such as through the inclusion of private investments in retirement target date funds—in a manner that ensures incentive alignment with professional investors, similar to our public markets, and otherwise provides appropriate investor protections.

2. **As you may know, Rep. Hollingworth and Rep. Gottheimer have sponsored legislation, the Senior Security Act, which passed the House in April that would establish an interdivisional taskforce within the SEC to focus on senior protection.**
  - a. **Are you familiar with the legislation?**
  - b. **Neither office has received feedback from the SEC. Do you support the bill in its present form? Why or why not? Do you recommend any modifications?**
  - c. **Will you commit to working with the House and the Senate to get this bill into a form where it can be promptly and effectively implemented by the SEC?**

**Answer:**

The Commission takes very seriously the need to identify problems senior investors encounter and to protect seniors from bad actors in the securities markets. The Commission currently dedicates many resources to this important priority and draws on expertise from across the SEC to develop strategies and techniques for addressing the types of misconduct that most affect retail investors, including senior investors. One example of these efforts is the Retail Strategy Task Force (RSTF). Formed in 2017, the RSTF is focused on data-driven approaches to identifying and bringing enforcement actions against retail fraud, including against senior investors. While the RSTF is within the SEC's Division of Enforcement, the task force works with staff across the SEC's divisions and offices, including SEC's Office of Compliance Inspections and Examinations (OCIE) and Division of Economic and Risk Analysis (DERA). In addition, the RSTF coordinates with the Office of Investor Education and Advocacy (OIEA) to inform investors and the public about red flags involving securities fraud. For example, in 2018, when the SEC announced an enforcement action related to fraud targeting seniors, the RSTF and the OIEA also published an Investor Bulletin titled Ponzi Schemes Targeting Seniors.<sup>1</sup>

The SEC also works closely with our regulatory colleagues to combat senior fraud. Last May, in recognition of the one-year anniversary of Congress's passage of the Senior Safe Act, the SEC, the North American Securities Administrators Association (NASAA) and the Financial Industry Regulatory Authority (FINRA) issued a fact sheet to help promote greater reporting by broker-dealers, investment advisers and transfer agents of suspected senior financial exploitation. Additionally, led by the RSTF and Commissioner Roisman, last fall SEC staff hosted a roundtable on combatting elder investor fraud, which focused on the types of fraudulent and manipulative schemes currently targeting elder investors. This very informative discussion

<sup>1</sup> See Investor Alert: Ponzi Schemes Targeting Seniors (Apr. 9, 2018), *available at* <https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-alert-ponzi-schemes-targeting-seniors>.

featured panelists from our fellow regulators, including the Department of Justice, Department of Treasury (FinCEN), Consumer Financial Protection Bureau, NASAA and FINRA, as well as perspectives from both the industry and senior advocacy groups.

I know that the protection of senior investors is a priority for Congress and this Committee in particular—just as it is for the Commission. SEC staff have provided technical assistance to the House and Senate regarding the bill, and staff are available to continue providing technical assistance. While I do not have any concerns implementing the Senior Security Act as written, I believe Congress should consider whether future SEC chairs should have the flexibility to establish the taskforce in a way they believe is best suited to protect investors based on market and other developments. I would be pleased to work with this Committee on any legislative initiatives to improve senior investor protection and would prioritize their implementation if passed.

3. **Facebook announced plans to develop a new cryptocurrency, Libra, and a wallet for it to be stored on, Calibra, in June. It has been reported that Facebook did not engage with the SEC or its staff leading up to this announcement, and during his congressional testimony, David Marcus claimed that Libra wouldn't fall under the agency's jurisdiction because Libra would operate more like cash than a security, albeit some observers argue that it would operate as an ETF.**
  - a. **What is your opinion of Libra?**

**Answer:**

SEC staff continues to look closely at the Libra project and the federal securities laws implications that it could present. Given that details about the project are still developing, it would be premature to reach any conclusions as to the application of the federal securities laws to the Libra project, nor would it be appropriate for me to comment on a specific product.

Without referencing any specific product, over the years we have developed an ecosystem of financial regulation—securities, commodities, currencies and payment systems—that deals with a great deal of risk to investors and our markets more generally. To the extent a digital asset would be used to evade these regulations, I would have a real problem with that.

Additionally, simply calling a digital asset a “payment means” or “currency” does not mean that it is not a security. Whether a particular transaction involves the offer and sale of a security—regardless of the terminology used to identify the digital asset—will depend on the facts and circumstances, including the economic realities of the transaction.

Generally, we look at whether the digital asset fits the definition of a security as set forth in the federal securities laws. The federal securities laws define “security” broadly. Digital assets that incorporate features and marketing efforts that emphasize the potential for profits based on the entrepreneurial or managerial efforts of others contain the hallmarks of a security under U.S. law. The agency will remain focused on issues presented by new technologies, and to ensure those initiatives that implicate the federal securities laws are done in accordance with our important investor protections.

- b. How are you monitoring this proposal? Besides the staff guidance issued earlier this year, what steps are you taking to ensure that there are enough parameters in this industry?**
- c. What steps do you think Congress should be taking?**

**Answer:**

SEC staff has had preliminary discussions with Facebook and its affiliates, both directly and in coordination with other U.S. regulators, concerning the Libra project as they seek to better understand the details of the project. As the Libra project develops, SEC staff will continue to examine the Libra project and the federal securities laws implications that it could present.

Generally, the Commission and staff have sought to establish a regulatory environment for investors and market participants that fosters innovation, market integrity and, ultimately, confidence in two ways: (1) engagement with market participants to assist those seeking to comply with the federal securities laws; and (2) close coordination with other regulators on matters relating to distributed ledger technology and other innovative technologies.

In October 2018, the SEC established FinHub to lead engagement efforts with the FinTech community. Part of that engagement has been to provide staff guidance and clarity to market participants, including the FinHub's April 2019 framework for analyzing whether a digital asset is offered and sold as an investment contract, and therefore, is a security. Division of Corporation Finance staff has subsequently issued two no-action responses to market participants indicating that the Division will not recommend enforcement action to the Commission if the digital assets described in the requests are offered or sold without registration under the federal securities laws. The Division of Corporation Finance staff also qualified two offering circulars for initial coin offerings pursuant to Regulation A, which demonstrates our commitment to working with entrepreneurs seeking to conduct ICOs in compliance with the federal securities laws. The Division of Trading and Markets staff issued a time-limited no-action response to a market participant that the Division will not recommend an enforcement action for certain clearance and settlement activity by the participant to evaluate the potential benefits of a settlement service using distributed ledger technology without being registered as a clearing agency. Additionally, in July 2019, the Division of Trading and Markets staff issued a Joint Statement with FINRA staff on Broker-Dealer Custody of Digital Asset Securities. In November 2018, the Divisions of Corporation Finance, Investment Management, and Trading and Markets issued a statement on digital assets issuance and trading, which included details about how two companies that had conducted unregistered securities offerings through ICOs had remediated and moved forward. In January of 2018, the Division of Investment Management issued a letter inviting engagement on a variety of digital asset issues, including custody, valuation, liquidity, manipulation, and arbitrage. In March 2019, the Division of Investment Management issued another letter welcoming public input on digital asset custody issues.

The FinHub staff continues to conduct outreach in a number of ways, including by hosting local peer-to-peer meetings to engage with FinTech communities across the country and

also held a public FinTech Forum last year that focused on distributed ledger technology and digital assets. I believe these efforts, among others, demonstrate the FinHub's commitment to regulatory clarity while maintaining our important investor protections.

In addition to engagement with market participants, we have closely coordinated with our fellow regulators on issues relating to digital assets. Distributed ledger technology involves the issuance and transfer of digital assets, which could be securities, commodities, derivatives, or something else, and there is potential for regulatory overlap. As such, the SEC staff works closely with other regulators—including the CFTC, FinCEN, and through the FSOC's digital assets and distributed ledger technology working group—to coordinate our activities to the extent possible and appropriate under the circumstances. Additionally, we actively monitor international developments related to FinTech and digital assets and engage with foreign regulators on a bilateral and multilateral basis to further its understanding of these issues. Bilaterally, SEC staff regularly meets with foreign counterparts to share experiences and lessons learned on a wide range of FinTech topics. Multilaterally, staff directly participates in a number of ongoing initiatives by international bodies such as the Financial Stability Board (FSB), International Organization of Securities Commissions (IOSCO), the Financial Action Task Force (FATF) and the Global Financial Innovation Network (GFIN).

I believe Congress has an important oversight role in the digital asset space. I believe the existing principles-based framework of our federal securities laws have served us well in providing efficient tools for the SEC to demonstrate its commitment to fostering innovation that may be beneficial to the markets and investors, while remaining vigilant in our mission to protect investors and the markets against harm. The Commission has generally approached how to regulate an instrument not by the name it is given, but rather the underlying economic substance, how it is offered and sold, and whether it presents issues of investor protection that our federal securities laws are designed to address. As distributed ledger technology is nascent and fast-changing, I believe it is useful to continue to monitor developments to determine what, if any, additional legislative action may be appropriate. In the meantime, the Commission and its staff continue to oversee compliance with the federal securities laws, engage with industry participants and closely coordinate with our domestic and international regulatory partners in this space. At this time, we have not identified areas for congressional action, but I will let you know if that need arises.

- 4. Is Congress right to be concerned that the size of the private marketplace exceeds the public marketplace? How would you characterize the protections that currently exist in the private placement marketplace for retail investors? Are they adequate?**

**Answer:**

Our private markets have become increasingly important and are now often seen as more attractive for companies and professional investors than our public markets, in terms of amounts of capital raised, investment opportunities and returns, among other metrics. However, the private market regulatory framework—one that is heavily reliant on our wealth-based definition of “accredited investor”—is rooted in the markets, technology and employment and professional relationships that existed thirty or more years ago. As a result, access to potentially attractive

investment opportunities for Main Street investors who do not meet those wealth standards is limited and, where it is available, costly. Additionally, the private offering framework often does not function well for small and medium-sized companies seeking to grow beyond the start-up stage, particularly those that do not have established relationships with professional investors.

Congress and the SEC have long sought to expand Main Street access—and small business access—to our private capital markets while preserving investor protection. Recent initiatives include: (1) Regulation Crowdfunding, (2) expanding Regulation A, and (3) lifting the ban on general solicitation for Rule 506 offerings under Regulation D. These various efforts have had benefits, but they also have added new patches to an already patchwork regulatory framework that remains rooted in binary income and wealth tests for investor access.

In March 2020, the Commission proposed a set of amendments that would harmonize, simplify and improve the exempt offering framework. The proposed amendments seek to promote capital formation and expand investment opportunities while preserving and enhancing investor protections. The recommendations were informed by feedback we received on a concept release the Commission issued in June 2019, seeking comment on possible ways to harmonize the exempt offering framework to expand investment opportunities and promote capital formation while maintaining appropriate investor protections. In both the proposal and the Concept Release, the Commission noted that the regulatory framework for exempt offerings has evolved and the significance of the exempt markets has increased both in terms of the absolute amounts raised and relative to the public registered markets. The current exempt offering framework consists of a number of different exemptions from registration, each with its own set of requirements, conditions and investor protections. For example, the exemptions contain different levels of disclosure requirements; some contain investment limits meant to protect investors; some are limited to certain types of sophisticated investors; and some are limited to offerings of certain sizes. The investor protections built into the exemptions are meant to be tailored to the exemption. As a practical matter, there are certain private offerings in which investors receive more information about the issuer than they would in a public registered offering.

Our work in this area is ongoing. The staff and I will continue to explore possible steps to facilitate greater Main Street investor access to private investments through appropriately structured funds—such as through the inclusion of private investments in retirement target date funds—in a manner that ensures incentive alignment with professional investors, similar to our public markets, and otherwise provides appropriate investor protections. In formulating recommendations in this area, the staff will be focused on ways to maintain—or enhance—investor protections.

**5. How does the Commission reconcile their statements in the Concept Release about wanting to encourage more IPOs, but at the same time, expanding the private markets?**

**Answer:**

I do not believe it is inconsistent for the Commission to seek to encourage more public companies while simultaneously modernizing our private market capital-raising framework. I

believe both will have significant benefits for both investors and issuers. In answering this question, it is important to think about three things: (1) why fewer companies going public in the United States; (2) the principle causes of this shift, and (3) what we are doing about it.

First, the fact that fewer companies are going public in the U.S. concerns me because investors without access to the private markets are limited in their ability to diversify their portfolios and, as companies stay private longer, investors can lose out on opportunities to participate in company growth and earn a return on investment. Additionally, it is my experience, and the view of our Director of Corporation Finance, that companies that go through the SEC public registration and offering process often come out as better companies, providing meaningful benefits to the company, investors and our capital markets.

Second, we have approximately one half of the number of public companies we had 20 years ago; growing companies are staying private substantially longer; public equity markets—e.g., IPOs—are being used more for liquidity by venture capital and private equity investors than for accessing new growth capital; and many large, international companies are not listed in the United States. I believe this is due to a combination of many factors, including regulation, the emergence of a private ecosystem, globalization of capital allocation (as well as supply and distribution channels) and fiscal and monetary policy.

Third, we need to understand how we got here while recognizing we are unlikely to recreate the public markets of 20 years ago. So I believe we need work to both: (1) increase the attractiveness of our public capital markets as places for companies to raise growth capital, and (2) increase the type and quality of opportunities for our Main Street investors in our private markets.

6. **We continue to have a significant lack of information about the private marketplace. Even figures like \$3 trillion in private markets are, by the SEC's own admission, merely an estimate. Given this lack of information, and the corporate governance and valuation problems of privately-held companies, as recently highlighted by WeWork, it is concerning that the SEC is looking to push more retail investors into highly risky and speculative private placements; investments that do not appear to be in retail investors' "best interest."**
  - a. **Shouldn't the SEC be more focused on getting basic information about private markets before they consider such fundamental changes to those markets and putting Main Street investors at risk?**
  - b. **What efforts, specifically, has the SEC engaged in to obtain this basic information?**

**Answer:**

Retail investors generally do not have meaningful opportunities to participate in the private markets. As a result, in an environment where many companies are choosing to stay private much longer, retail investors are unable to participate in much of the growth of those companies. When they do have opportunities, they often are costly and less attractive than opportunities available to large institutional investors. The Commission is not looking to push

retail investors into highly risky and speculative private placement investments. Rather, we are exploring whether there are ways to expand the type and quality of opportunities for those investors in our private markets as they have overtaken our public markets, in some respects, as the primary source of growth capital. In formulating recommendations in this area, the staff will consider ways maintain—or enhance—investor protections.

Commission staff regularly studies activity in the private markets. For example, in August 2018, staff in the Division of Economic and Risk Analysis published an analysis of the market for unregistered securities offerings from 2009-2017.<sup>2</sup> This study examined offering characteristics, including the types of issuers, investors and financial intermediaries that participate in Regulation D offerings. The study also analyzed new and amended exemptions created by the Jumpstart Our Business Startups (JOBS) Act of 2012, including Rule 506(c), Regulation A and Regulation Crowdfunding.

In March, the Commission proposed a set of amendments that would harmonize, simplify and improve the exempt offering framework. The proposed amendments seek to promote capital formation and expand investment opportunities while preserving and enhancing investor protections. The recommendations were informed by feedback we received on a concept release the Commission issued in June 2019 seeking comment on possible ways to harmonize the exempt offering framework to expand investment opportunities and promote capital formation while maintaining appropriate investor protections. To assist the Commission in considering the incidence of fraud in the private markets, both the proposal and the concept release specifically sought quantitative data on fraudulent activity in the context of securities offerings conducted pursuant to a valid exemption from registration. Recognizing difficulties in drawing rigorous conclusions about the average magnitude of investor gains and losses in exempt securities offerings, the Commission also sought data about the performance of investments in exempt markets.

Our work in this area is ongoing, and the staff is continuing to review feedback we received on the concept release and on the proposal.

- 7. During the hearing, Mr. Gottheimer asked you about your views regarding the Senior Security Act, and specifically, whether you had any concerns or objections to the bill as passed by the House earlier this year, including its mandate that the SEC to establish and interdivisional task force under your leadership that will focus on the protection and service of senior investors. When Mr. Gottheimer asked if you had any concerns about having such a task force constituted in such a way that it would report directly to you, you stated that this idea was “crazy...don’t believe everything you hear.” Can you please confirm that you support the creation of such a task force, under your direction, and that the SEC would not have any problem implementing the requirements of the**

<sup>2</sup> See Scott Bauguess, Rachita Gullapalli and Vladimir Ivanov, Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017 (Aug. 2018), available at [https://www.sec.gov/files/DERA%20white%20paper\\_Regulation%20D\\_082018.pdf](https://www.sec.gov/files/DERA%20white%20paper_Regulation%20D_082018.pdf). This study was a follow-up to a study conducted in 2015, which provided an analysis of capital raised through unregistered offerings for the period of 2009-2014. See Scott Bauguess, Rachita Gullapalli and Vladimir Ivanov, Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2016 (Oct. 2015), available at [https://www.sec.gov/dera/staff-papers/white-papers/30oct15\\_white\\_unregistered\\_offering.html](https://www.sec.gov/dera/staff-papers/white-papers/30oct15_white_unregistered_offering.html).

**bill as passed by the House? Alternately, if you have any concerns about the bill or feel it should be modified prior to being enacted, will you please explain them?**

**Answer:**

I have no concerns. The Commission takes very seriously the need to identify problems senior investors encounter and to protect seniors from bad actors in the securities markets. The Commission currently dedicates many resources to this important priority and draws on expertise from across the SEC to develop strategies and techniques for addressing the types of misconduct that most affect retail investors, including senior investors. One example of these efforts is the Retail Strategy Task Force (RSTF). Formed in 2017, the RSTF is focused on data-driven approaches to identifying and bringing enforcement actions against retail fraud, including against senior investors. While the RSTF is within the SEC's Division of Enforcement, the task force works with staff across the SEC's divisions and offices, including SEC's Office of Compliance Inspections and Examinations (OCIE) and Division of Economic and Risk Analysis (DERA). In addition, the RSTF coordinates with the Office of Investor Education and Advocacy (OIEA) to inform the public about red flags involving securities fraud. For example, in 2018, when the SEC announced an enforcement action related to fraud targeting seniors, the RSTF and the OIEA also published an Investor Bulletin titled Ponzi Schemes Targeting Seniors.

The SEC also partners works closely with our regulatory colleagues to combat senior fraud. Last May, in recognition of the one-year anniversary of the passage of the Senior Safe Act, the SEC, the North American Securities Administrators Association (NASAA) and the Financial Industry Regulatory Authority (FINRA) issued a fact sheet to help promote greater reporting by broker-dealers, investment advisers and transfer agents of suspected senior financial exploitation. Additionally, led by the RSTF and Commissioner Roisman, last fall SEC staff hosted a roundtable on combatting elder investor fraud, which focused on the types of fraudulent and manipulative schemes currently targeting elder investors. This very informative discussion featured panelists from our fellow regulators, including the Department of Justice, Department of Treasury (FinCEN), Consumer Financial Protection Bureau, NASAA and FINRA, as well as perspectives from both the industry and senior advocacy groups.

Regarding the objectives of the Senior Security Act, as I have previously mentioned and want to emphasize again, the protection of retail investors—including our senior investors—is and continues to be a priority for the Commission where we have already dedicated many resources. Should Congress pass legislation to create a new Senior Task Force within the SEC, the Commission would prioritize its implementation.

I know that the protection of senior investors is a priority for Congress and this Committee in particular—just as it is for the Commission. SEC staff have provided technical assistance to the House and Senate regarding the bill, and staff are available to continue providing technical assistance. While I do not have any concerns implementing the Senior Security Act as written, I believe Congress should consider whether future SEC chairs should have the flexibility to establish the taskforce in a way she believes is best suited to protect investors based on market and other developments. I would be pleased to work with this

Committee on any legislative initiatives to improve senior investor protection, and would prioritize their implementation if passed.

**8. The SEC recently published a Concept Release relating to modernization of the exempt offering framework. The comment deadline was September 24<sup>th</sup>.**

- a. As you know, SEC Rule 506(c) – which permits general solicitation – requires that the issuer takes “reasonable steps” to verify purchasers’ accredited investor status prior to any sale of securities. As you may not know, this requirement is the result of compromise reached in this Committee during our consideration of the legislation that would be enacted in as the JOBS Act of 2012. In fact, as the then-Ranking Member of the Capital Markets Subcommittee during that time, Chairwoman Waters authored and offered the amendment that imposed this requirement – and the Committee approved the amendment unanimously.

The Concept Release appears to contemplate revising Rule 506(b) and Rule 506(c) in a manner that could directly or indirectly undermine this important protection – for example, by proposing to “combine the requirements for Rule 506(b) and Rule 506(c) offerings in one exemption” and by requesting information about “alternatives” to the present verification guidelines that will [increase] “the willingness of issuers to use Rule 506(c).”

Can you assure the Committee that any revisions that Commission might make will not seek to weaken or undermine the requirement that issuers take “reasonable steps” to verify accredited status in Rule 506(c) offerings? Can you assure the Committee that any action to “combine the requirements for Rule 506(b) and 506(c) offerings in one exemption” will retain this critical protection?

**Answer:**

Section 201(a) of the JOBS Act required the Commission to eliminate the prohibition on using general solicitation under Rule 506 where all purchasers of the securities are accredited investors and the issuer takes reasonable steps to verify that the purchasers are accredited investors. In implementing this statutory mandate, the Commission adopted Rule 506(c) and provided a principles-based method for verification of accredited investor status. The rule also contains a non-exclusive list of verification methods. As noted in the concept release, market participants have communicated to the staff that many issuers rely primarily on the non-exclusive list of verification methods. The concept release sought comment on whether reasonable steps to verify requirement has an impact on the willingness of issuers to use Rule 506(c) and whether additional or alternative methods of verification should be added to the rule.

With respect to the question in the concept release about combining the requirements of Rule 506(b) and 506(c), the Commission asks a follow-up question about whether legislative changes would be necessary to make such change. This question recognizes that the JOBS Act requires reasonable steps to verify accredited investor status. In March 2020, based on feedback

received in response to the concept release, the Commission proposed a set of amendments that would harmonize, simplify and improve the exempt offering framework. Among other things, the Commission proposed the addition of a new item to the non-exclusive list of verification methods in Rule 506(c) that would allow an issuer to establish that an investor for which it previously took reasonable steps to verify as an accredited investor remains an accredited investor as of the time of a subsequent sale if the investor provides a written representation to that effect and the issuer is not aware of information to the contrary. I believe that this new method would reduce the cost and burden of verification for issuers and investors, including when issuers opt to engage in more than one Rule 506(c) offering over time. Investors' privacy concerns may also be alleviated, because they would not be asked to repeatedly provide financially sensitive information to the issuer, while the risk of investor harm would be mitigated by the pre-existing relationship between the issuer and such investor.

- b. There is much concern over the Commission's presumption in the Concept Release that retail investors would benefit from greater exposure to the private marketplace. This proposition seems especially dubious at the present moment in time – when there is increasing evidence that the private valuations of many large privately held companies are in some cases wildly inflated and tend to decline or outright collapse under scrutiny of the public marketplace. Indeed, many of the tech industry's highest-profile startups have largely bombed on the stock market since they went public this year. The value of Lyft has been cut in half. Its rival Uber is down over 25 percent. Slack and Peloton are trading well below their IPO prices. And, of course, WeWork's ambitions crashed into reality when public investors balked at the company's price tag, leading the company to pull its IPO altogether rather than post its substantial red ink.**

**Is the trend toward greater and greater disparity in private vs. public valuations, as exemplified by the recent IPOs above, a cause for concern? Does it support the view that retail investors should have greater exposure to the private marketplace? If there is a bubble of sorts in the private marketplace, as some have suggested, why should the SEC now be pushing more retail investors into this marketplace?**

**Answer:**

One of my priorities is to provide Main Street investors with greater investment opportunities—both in the public and private markets. This is different from pushing them in one direction or another. I do believe, however, that Main Street investors could benefit from expanded investment opportunities in the private markets. We have roughly half the number of public companies we had 20 years ago; growing companies are staying private substantially longer; and public equity markets are being used more for liquidity by venture capital and private equity investors than for accessing new growth capital. Main Street investors generally do not have opportunities to participate in the private markets. When they do, those opportunities often are costly and less attractive than opportunities available to large institutional investors. Investors without access to the private markets are limited in their ability to diversify their portfolios. They also cannot participate in the growth of companies that stay private longer. I believe the Commission should look for ways to expand the type and quality of opportunities for

Main Street investors both in our public and private markets while maintaining or enhancing investor protections.

- c. **The Concept Release suggests at several points that the Commission could use its ability to preempt state authority to regulate exempt transactions via the SEC's power to define transactions as involving "qualified purchasers" (e.g., at page 13 of the Concept Release). Please explain what if any limitations you see on the SEC's authority to define the term "qualified purchaser" to preempt state laws. Do you think Congress should further clarify and perhaps limit the SEC's perceived authority in this regard? How?**

**Answer:**

I do not believe there is need for congressional clarification with respect to the definition of "qualified purchaser." Section 18(b)(3) of the Securities Act of 1933 provides that a security is a "covered security" with respect to the offer or sale of the security to "qualified purchasers," as defined by the Commission by rule. Section 18(b)(3) further provides that the Commission may define the term "qualified purchaser" differently with respect to different categories of securities, consistent with the public interest and the protection of investors.

9. **The Committee on Financial Services would like to ask you about the SEC's oversight of federally-registered investment advisers. We are now in the ninth year of a bull market, and my experience has been that when the markets are going up, it is comparatively easier for the crooks to hide their criminal activity – but when the market stops going up, that sometimes reveals schemes and scams under the surface, such as those we saw a decade ago from the likes of Bernie Madoff and Allen Stanford. Does the SEC have the resources it needs to conduct sufficient oversight and examinations of federally-registered IAs to deter and detect fraud? How concerned are you that when this bull market ends, as it eventually must, we'll see the kind of thefts we saw in 2009-2010?**

**Answer:**

With the lifting of the hiring freeze and funding support provided by Congress, I have prioritized resources with respect to the SEC's examination and inspection function, which is primarily led by the Office of Compliance Inspections and Examinations (OCIE). OCIE has taken a number of steps to enhance its oversight of SEC-registered investment advisers (RIAs) and to help detect and prevent the types of fraud and misconduct that you identified, including:

- Enhancing its risk-based examination program that focuses on the highest risk RIAs and practices that have the greatest risk of potential harm to investors and the markets. As part of its risk assessment, OCIE now considers dozens of potential risk factors, which can include: products and services offered; compensation and funding arrangements; prior examination observations and conduct; disciplinary history of associated individuals

and affiliates of the RIA; changes in leadership or other personnel; and whether the RIA has access to investor assets.

- Providing additional transparency by publishing annual Examination Priorities to focus on certain practices, products and services that the staff believes present heightened risk to investors or the integrity of the U.S. capital markets, which may help RIAs focus their own internal compliance reviews and facilitate the ability to anticipate and preemptively solve common compliance issues.
- Leveraging technology and data analytics tools that can scan arrays of data fields to help examiners analyze and identify potentially problematic RIAs, allowing exam staff to make better decisions concerning RIAs to examine and appropriately scope those examinations.
- Committing significant resources to verifying RIA assets at custodians, and in instances where RIAs have access to client funds or securities, prioritizing examinations for compliance with the Custody Rule, which includes important client safeguards like third party audits and surprise examinations.

As a result of additional staff (from new hires and by redeploying existing staff), increased efficiencies, targeted exam initiatives and improved use of technology, the SEC was able to increase examination coverage RIAs over the past several years from 10 percent in FY 2014 to a high of 17 percent in FY 2018.<sup>3</sup> While this has been a very positive step, more needs to be done to continue to increase investment adviser examination coverage levels, while at the same time being careful to avoid decreasing examination quality. To that end, the SEC will continue to explore additional efficiencies and improvements to our risk-based examination program. Additionally, where appropriate, over the years OCIE has on many occasions—and will continue to—refer conduct to the SEC’s Division of Enforcement, which may conduct an investigation into potential fraud when necessary.

**10. Positions taken by some foreign authorities currently significantly impair or outright prevent the PCAOB’s ability to inspect non-U.S. audit firms in foreign countries, yet these companies are still able to be traded in U.S. public markets. For example, the PCAOB is currently restricted from inspecting audit work and practices of PCAOB-registered firms in China.**

- a. Are you concerned that these foreign companies, particularly Chinese companies, are using foreign laws to circumvent U.S. legal requirements while unfairly accessing U.S. capital markets?**

I am concerned about the current unlevel playing field for issuers from certain emerging markets, including China, and its impact on investors. I believe the status quo is unacceptable and look forward to continuing to work with Congress to ensure transparency and confidence in our markets.

<sup>3</sup> OCIE’s coverage of RIAs in FY 2019, a year in which the population continued to increase and the SEC experienced a 35-day lapse in appropriations, was 15 percent.

Over the past decade, U.S. investors, and the U.S. capital markets more generally, have increased exposure to companies with significant operations in emerging markets, including China—the largest emerging market and the world’s second largest economy. Investments in emerging markets, including China, entail significant disclosure, financial reporting and other risks for U.S. investors. Significantly, while the U.S. securities laws and regulations applicable to emerging market companies listed on U.S. exchanges are the same as (or comparable to) the laws and regulations applicable to U.S. public companies, the practical effects are substantially different, based on the inability of U.S. regulators to inspect for compliance and enforce these rules and regulations. This is a fundamental issue in emerging market investing that I believe investors, particularly our Main Street investors, should better understand.

In order to bring greater attention to these risks, SEC staff and I, along with the Chairman of the Public Company Accounting Oversight Board (PCAOB), have issued several joint statements outlining the significant risks related to investments in China due to the inability of the PCAOB to inspect audit work and practices of PCAOB-registered accounting firms in China. Investors should understand the potential impacts of the PCAOB’s lack of access when investing in companies whose auditor is based in China or where significant portions of the audit may have been performed by firms in China. The PCAOB periodically publishes a list of U.S.-listed companies where the PCAOB faces obstacles in inspecting the principal auditor’s work. Given the importance to investors of understanding the potential material risks related to the PCAOB’s lack of access related to PCAOB-registered accounting firms in China, issuers with operations in China should make clear disclosures regarding these risks, including highlighting these limitations as a risk factor, and some issuers disclosing the risk in their annual report that their auditors are not fully inspected by the PCAOB and, as such, shareholders do not receive the benefits of such inspection.

Recognizing the difficulties we face with inspection and enforcement particularly with respect to access to personnel and records in China, we have also engaged with U.S. auditing firms including certain of their global network representatives regarding the significance of their work and the importance of their diligence efforts with respect to their work in China. While these discussions with the audit firms are not intended to be a substitute for the PCAOB inspecting audit work and practices of PCAOB-registered accounting firms in China with respect to their audit work of U.S.-listed companies, these meetings have included discussions regarding audit quality across their global networks and the importance of effective and consistent oversight of member firms globally, including those operating in China and other emerging markets. In each of these meetings, the audit firms have recognized their responsibilities as auditors and acknowledged the importance of consistent audit methodologies across their global networks, and we were clear in sharing our expectations that they fulfill these responsibilities.

In addition to these meetings and public statements, there is a broader, continuing dialogue with U.S. audit firms and network representatives regarding the importance of effective and consistent oversight of member firms globally, including those operating in China and other emerging markets. The PCAOB has been in negotiations with foreign audit regulators in certain countries, including China, that currently prevent or constraint the PCAOB from carrying out its inspection process with respect to the audits of companies by audit firms based in those countries. Even while these negotiations are ongoing, a refusal to cooperate by an audit firm—

either in an inspection or an investigation—could subject the firm to SEC or PCAOB sanctions and remedial measures. Having the ability to impose sanctions and remedial measures may enhance the ability to make further progress with respect to such negotiations, but the imposition of such measures needs to be balanced with their potential impact on investors and the broader capital markets.

Depending on various facts and circumstances, including company-specific considerations, if significant barriers to effective inspections and regulatory oversight continue to exist in certain jurisdictions, remedial actions that involve or affect U.S.-listed companies with significant operations in those jurisdictions may be necessary or appropriate. There is a spectrum of potential actions. In the past, remedial measures have included, as examples, requiring affected companies to make additional disclosures, placing additional restrictions on new securities issuances and the adoption of more prescriptive, accountability-oriented listing standards. Some have suggested additional measures, including requiring the delisting of U.S.-listed companies who are audited by firms that the PCAOB is not sufficiently able to inspect or investigate, as well as the deregistration of audit firms themselves.

To further promote engagement and help inform our consideration of these issues, the SEC will be holding a roundtable to hear the views of investors, other market participants, regulators and industry experts on how we can continue to raise investor awareness of these risks and explore potential additional steps that can be taken to mitigate them. The ability to inspect for and enforce our laws and regulations is of paramount importance to U.S. investors and our capital markets more generally.

**11. You recently announced a change in the SEC's waiver application process. Under this new process, the Commission will now consider enforcement settlement offers that address both the underlying enforcement actions and the waiver of automatic disqualifications in the law under a single proposal. While this appears to be an attempt to streamline the waiver application process, there is much concern that there remains a lack of transparency surrounding how the Commission will analyze and apply relevant factors when considering waiver requests and that the Division of Enforcement will continue to use disqualification waivers as bargaining chips, as it has done extensively in the past. Can you please discuss how the new process addresses these concerns?**

**Answer:**

My July 2019 statement does not reflect a change to the substantive considerations that inform the Commission's assessment of settlement offers and waiver requests, nor does it reflect a change the manner in which the Commission considers the recommendations of the Division of Enforcement with regard to proposed settlements or the manner in which the Commission considers the recommendations of the Divisions of Corporation Finance and Investment Management with regard to requests for waivers. Rather, the statement makes our processes more transparent and efficient by increasing the ability of the Commission to provide an entity with certainty regarding the consequences of a settled action.

The Division of Enforcement has not used disqualification waivers as “bargaining chips” and will continue to not do so. To the contrary, the recommendations to the Commission regarding waivers are made by staff from one or both of the Divisions of Corporation Finance and Investment Management. The Divisions of Corporation Finance and Investment Management perform a robust analysis for each waiver request, taking into consideration the businesses and operations of the entity affected by the collateral disqualifications. The Division of Enforcement is not involved in making determinations regarding “bad actor” or WKSJ waiver recommendations to the Commission. The Commission is, of course, under no obligation to accept any settlement offer and may determine not to accept a simultaneous offer of settlement and waiver request on the basis of form alone.

**12. As you know, the Dodd-Frank Act created a whistleblower program at the SEC that provides monetary awards to whistleblowers who contribute “original information” that results in monetary sanctions of over \$1 million. In addition, Dodd-Frank explicitly protects whistleblowers from retaliation by their employers for reporting suspected misconduct. However, in 2018, the Supreme Court held that whistleblowers who report alleged misconduct internally, but not to the SEC, are not protected by the anti-retaliation provisions of Dodd-Frank. As a result, employees may be less likely to report suspected misconduct to their supervisors. Are you concerned that the Supreme Court’s holding could discourage employees from voicing their concerns and, instead, encourage them to take a more litigious position by going first to the SEC? Do you believe Congressman Green’s bill, the Whistleblower Protection Reform Act of 2019, will address these concerns?**

**Answer:**

Our whistleblower program has made substantial progress since its inception and has proven to be an invaluable component of our enforcement efforts. The Commission continues to evaluate the impacts of the Supreme Court’s decision in *Digital Realty v. Somers*, 138 S. Ct. 767 (2018), on the SEC’s whistleblower program, including whether some individuals will be disincentivized from reporting internally and will instead report information to the Commission in the first instance. I continue to believe that robust corporate compliance programs can be effective in identifying, correcting and self-reporting securities law violations. The SEC’s rules recognize this potential through provisions intended to incentivize impactful internal whistleblower reporting by allowing the Commission to increase an award percentage based on whether, and the extent to which, a whistleblower reported the possible securities violations through internal whistleblower, legal or compliance procedures before, or at the same time as, reporting them to the Commission. The Supreme Court’s ruling in *Digital Realty*, however, has created tension between the incentives to internally report through the whistleblower rules and the lack of anti-retaliation protections under the Dodd-Frank Act for a whistleblower who reports internally without first or contemporaneously reporting to the Commission. I believe legislation to expand the anti-retaliation protections to those individuals who report misconduct internally regardless of if and when they report to the Commission would address these concerns, and I welcome the opportunity to work with the House and Senate in furtherance of this objective.

- 13. In 2015 the SEC issued a proposed rulemaking that addressed several flaws that currently exist with regard to federal clawback provisions for unearned executive pay. There is a growing body of empirical evidence indicating that the 2015 proposal would likely improve financial reporting quality while enhancing the advantages of performance-based compensation for public company executives. Can you provide us with some assurance that you will promptly complete this long overdue rulemaking mandated by Congress in the Dodd-Frank Act?**

**Answer:**

It is the Commission's obligation to complete the rules mandated by Congress in Dodd-Frank. Executive compensation is an area where private markets have been active in shaping policies and practices. In this regard, many companies already have made public their policies regarding clawbacks. Many of these policies go beyond what would be required under the Dodd-Frank Act mandate. In other words, they apply to situations other than financial fraud. A few companies have attempted to claw-back compensation from their executives under these policies. Any rules proposed and ultimately adopted by the Commission should reflect these observable market developments.

- 14. The Committee on Financial Services would like to ask you about the Insider Trading Prohibition Act authored by Representative Himes. U.S. District Judge Jed Rakoff argued in 2015 that "if unlawful insider trading is to be properly deterred, it must be adequately defined. The appropriate body to do so, one would think, is Congress." And even the late Justice Scalia argued that "only the *legislature* may define crimes," and that Congress shouldn't leave the job of defining insider trading to the courts. Can you discuss why it's important for laws that have criminal consequences to be clearly defined by statute? What are the benefits to the SEC — and to investors — of Congress codifying insider trading law?**

**Answer:**

I commend Congress for grappling with the issues that are most sensitive in insider trading, which is an issue that the courts have grappled with for a long time. Framing my answer to civil insider trading enforcement by the SEC (as the SEC does not have criminal enforcement authority), I believe the SEC has built up over time a very valuable body of case law—as well as staff expertise in pursuing investigations and actions under this framework—which I believe is important to retain with any legislation codifying a definition of insider trading.

I understand the Second Circuit's decision in *United States v. Newman* caused concern; however, I believe those concerns have been substantially mitigated by the Supreme Court's subsequent decision in *Salman v. United States* and the Second Circuit's decision in *United States v. Martoma*. While I do not want to give up what the SEC has learned over the course of the past 30 years enforcing this law and trying to improve it, I stand ready to continuing to work

with Congress to ensure any legislation addressing insider trading strikes the right balance and is neither over- nor under-inclusive.

- 15. As you know, public companies are required to disclose significant corporate events to investors and the public on Form 8-K within 4 business days after the event occurs. That means that corporate executives and insiders have the benefit of knowing material, nonpublic information for 4 days before investors and the rest of the public, yet there is no SEC rule prohibiting these executives from buying or selling the company's shares during this 4-day gap. Indeed, a 2015 study conducted over a 6-year period found that insiders who traded during this 4-day gap successfully earned \$105 million in above-market returns on these trades. Would you support legislation like Rep. Maloney's 8-K Trading Gap bill that seeks to close this loophole and prohibit officers and directors from trading company stock after the company has determined that a significant event has occurred?**

**Answer:**

Trading on the basis of material non-public information is illegal under current law, even when SEC rules do not expressly prohibit all trading during this window. As I have previously testified, I believe it is good corporate hygiene for reporting companies to have in place policies, controls and procedures designed to prohibit officers and directors of the issuer from trading during that period if the officers and directors are in possession of material non-public information. I look forward to continuing to engage with Congress on this issue.

- 16. Studies have shown that US companies that disclose their human capital investments "are disproportionately and consistently" outperforming their non-disclosing competitors. You yourself have said, quote, "If I am an investor looking at businesses today, I want to know what you are doing with your human talent, how you are growing your human talent, how you are accessing new talent, how you are retaining existing talent, how you are enhancing." Can you please explain why a company's investment in its human capital is important for investors to know? Do you believe investors are disadvantaged by not having access to human capital management information?**

**Answer:**

The strength of many of our public companies is due, in no small part, to their human capital. The Commission's approach to disclosure in this area has been consistent with our ongoing commitment to ensure that our disclosure regime provides investors with a mix of information that facilitates well-informed capital allocation decisions. This commitment has been, and in my view should remain, disclosure-based and rooted in the concept of materiality, including providing investors with insight regarding the issuer's assessment of, and plans for addressing, material risks to its business and operations. The SEC regularly evaluates our existing rules and attempts to ensure they reflect current and future industry and market realities and have not become outdated or unnecessary.

The Commission has taken a number of actions to update disclosure requirements in an effort to enhance the quality of information available to investors. As one example, in August 2019, the Commission proposed amendments to modernize the description of business, legal proceedings and risk factor disclosures that registrants are required to make pursuant to Regulation S-K. The proposed amendments would include as part of a registrant's business disclosures, a description of the registrant's human capital resources, to the extent material. The proposed amendments recognize that intangible assets, and in particular human capital, are often a significant driver of value in today's economy. In recognition that human capital measures or objectives used by management may change over time and may vary by industry, the proposed rule provides non-exclusive examples of human capital measures and objectives that may be material, depending on the nature of the registrant's business and workforce, such as measures or objectives that address the attraction, development, and retention of personnel.

We have received a number of comments and wide range of input. Staff in the Division of Corporation Finance staff is evaluating comments received, and I look forward to the staff's recommendations.

**17. You have said that you plan on fully implementing Regulation Best Interest by June of 2020. However, seven states and the District of Columbia have brought suit against the SEC alleging that in promulgating the Rule the Commission exceeded its authority; that Reg B.I. violates Dodd-Frank because it does not hold broker-dealers to the same fiduciary standard as investment advisers; and that the Rule is arbitrary and capricious because the Commission willfully ignored its own evidence that showed the Rule exacerbates investor confusion. In light of these extraordinary allegations, do you intend to revise the June 2020 implementation deadline?**

**Answer:**

While I will not comment on any pending litigation, at present time, there is no plan to change the June 30, 2020 implementation date for Regulation Best Interest.<sup>4</sup> It is critical to put in place the important investor protections contained in Regulation Best Interest, and I believe firms are making good faith efforts to be ready to implement by that time.

**18. Earlier this month, the SEC's Division of Corporation Finance announced that it would begin issuing oral, rather than written, guidance for some requests to exclude shareholder proposals from a vote under Rule 14a-8. The Division also noted that if the staff declined to take a view, it should not be interpreted to mean a proposal must be included. This is a departure from the current system, where companies and shareholders are able to get informal staff opinions in writing to help them understand how the Commission may view such a proposal under its rules. Many fear that the new policy will create an enormous amount of uncertainty for companies. It may also result**

<sup>4</sup> See SEC Chairman Jay Clayton, Confirmation of June 30 Compliance Date for Regulation Best Interest and Form CRS (June 15, 2020), available at <https://www.sec.gov/news/public-statement/clayton-compliance-date-regulation-best-interest-form-crs>; SEC Chairman Jay Clayton, Investors Remain Front of Mind at the SEC: Approach to Allocation of Resources, Oversight and Rulemaking; Implementation of Regulation Best Interest and Form CRS (Apr. 2, 2020), available at <https://www.sec.gov/news/public-statement/statement-clayton-investors-rbi-form-crs>.

in frivolous proposals being included for a vote, and the exclusion of meritorious proposals for fear of litigation.

- a. Why have you rescinded decades of a practice that was working and what is being done to provide companies with compliance certainty?
- b. The number of no-action requests regarding shareholder proposals has been declining in recent years. Why then, has the Staff recently announced that they need to stop issuing written decisions in each case?

**Answer:**

The staff will continue to respond to every Rule 14a-8 no-action request submitted and will continue to be transparent about its decisions with the public. What has changed is the form of the staff's response:

- The staff will not issue a letter in response to every no-action request. Rather, the staff will issue a letter where the staff believes doing so will provide valuable guidance to companies and proponents in complying with Rule 14a-8.
- Instead of issuing a letter, the staff will generally provide its responses to 14a-8 no-action requests in a chart that is posted on the Division of Corporation Finance's webpage, which will be updated at least once a week with new decisions. The chart will reflect all of the staff's responses, including responses where the staff has issued a letter and provides hyperlinks to the no-action request and other related correspondence from the company and the shareholder proponent.

In some instances, the staff may decline to express a view on a particular no-action request. That determination will depend upon the particular facts and circumstances of the company's no-action request and proposal. This flexibility is something the staff has always had and has used in limited circumstances. Corporation Finance staff has not used it this proxy season with respect to the proposals it has received to date.

The staff believes this streamlined process will allow the staff to make more efficient use of the Division's resources, while continuing to provide guidance to companies and proponents in complying with Rule 14a-8. Additionally, the chart will enhance the transparency of the staff's decisions by making it easier for the public to review the staff's decisions and access the related correspondence.

**19. Chairwoman Waters introduced, and the House passed, an amendment to an appropriations bill that would prevent the SEC from using funds to revise the threshold for shareholder proposals or resubmissions under Rule 14a-8. What is the status of your project to amend the Rule 14a-8 shareholder proposal rule?**

**Answer:**

Modernizing and enhancing the efficiency of the proxy process for the benefit of all shareholders is a priority of mine. In November 2019, the Commission proposed amendments to modernize the rule that governs the process for shareholder proposals to be included in the company's proxy statement. The proposed amendments have been carefully crafted to more

appropriately balance the benefits and burdens to all shareholders, while, importantly, retaining the ability of small, medium- and long-term shareholders to continue to enter and engage in the shareholder proposal process. Specifically, the proposed amendments would replace the current ownership requirements with a tiered approach that would provide three options for demonstrating an ownership stake through a combination of the amount of securities owned and length of time held. The proposal maintains the long-standing \$2,000 minimum ownership threshold for shareholders provided they have owned their shares for three or more years. The proposed amendments also would amend the current resubmission thresholds of 3, 6, and 10 percent—which have not been updated since 1954—to 5, 15, and 25 percent, respectively, and allow companies to exclude shareholder proposals under certain circumstances where shareholder support for the matter has declined.

I welcome additional input on these matters, including suggestions for improving the proposals. The staff will consider comments received in any recommendations it may make to the Commission with respect to final rules.

**20. At the SEC’s November roundtable on the proxy process there was significant support from a broad range of market participants for the SEC to promptly complete its 2016 proposal on universal proxy. As you know, because of a quirk in existing SEC rules, shareholders are currently not allowed to vote from among all of the available director candidates in a proxy contest unless they attend the annual meeting in person. Can you provide us with some assurance that you will promptly complete this long overdue commonsense rulemaking?**

**Answer:**

In addition to the two Commission proposals to date to improve the proxy process, I expect the Commission’s work to modernize and enhance the proxy process to continue. For example, I believe the “proxy plumbing” and the proxy card (i.e., universal proxy) also are in need of modernization and retrospective review and have instructed the staff to prepare recommendations in these areas.

**21. The London Interbank Offered Rate, also known as the LIBOR, is slated to be discontinued at the end of 2021. What are the risks that the SEC sees in migrating away from a LIBOR benchmark? What is the SEC doing, or planning to do, to ameliorate these concerns? What do you need from Congress to ensure investors and the overall financial system is protected during this transition?**

**Answer:**

The expected discontinuation of LIBOR could have a significant impact on the financial markets and may present a material risk for certain market participants, including public companies, investment advisers, investment companies and broker-dealers. LIBOR is used extensively in the U.S. and globally for various commercial and financial contracts, including corporate and municipal bonds and loans, floating rate mortgages, asset-backed securities,

consumer loans, interest rate swaps and other derivatives, and LIBOR is expected to cease publication to be discontinued at the end of 2021.

The LIBOR transition could have a number of potential impact to financial markets and market participants. Many legacy contracts have interest rate provisions referencing LIBOR that, when drafted, did not contemplate the permanent discontinuation of LIBOR, and as a result, there may be uncertainty or disagreement over how the contracts should be interpreted. The expected discontinuation of LIBOR could have an impact on funds and advisers, particularly those that invest in instruments referencing LIBOR, such as floating-rate debt, bank loans, LIBOR-linked derivatives and certain asset-backed securities, as the discontinuation of LIBOR may impact the functioning, liquidity and value of these investments. Additionally, financial reporting issues might arise in connection with any transition from LIBOR to an alternative benchmark rate, including, for example, the accounting and financial reporting for modifications of terms within debt instruments, hedging activities, inputs used in valuation models and potential income tax consequences.

The SEC has been closely monitoring the LIBOR transition and have engaged extensively with both market participants and our regulatory counterparts in various forums. SEC staff participates as an ex-officio member of the Alternative Reference Rates Committee (ARRC), which was convened to identify a set of alternative USD reference rates and to identify an adoption plan to facilitate the voluntary acceptance and use of these alternative reference rates.

Additionally, we have taken a number of actions to emphasize the importance of this issue for market participants of every type. I have highlighted this issue in numerous testimonies before Congress, in speeches and public statements, in addition to direct engagement with market participants. My message has been clear: Market participants should assess their exposure to LIBOR and decide how to actively manage that risk and ensure that any contracts extending beyond 2021 either (1) reference LIBOR and have effective fallback language, or (2) do not reference LIBOR.

Additionally, in July 2019, SEC staff issued a statement that encourages market participants to proactively manage their transition away from LIBOR and outlines several potential areas that may warrant increased attention during that time. The staff statement encourages market participants to identify existing contracts that extend past 2021 to determine their exposure to LIBOR and to consider whether contracts entered into in the future should reference an alternative rate to LIBOR or include effective fallback language. Additionally, the statement provided specific staff guidance for how registrants might respond to risks associated with the discontinuation of LIBOR.

We will continue to monitor the transition away from LIBOR and potential impacts to our financial markets and market participants. SEC staff is closely monitoring the transition. At this time, we have not identified areas for congressional action, but I will let you know if that need arises.

**22. In 2014, the SEC's then-Director of Compliance reported that in an examination of 150 private equity advisers, the Commission found "violations of law or material weaknesses in controls over 50% of the time." And yet, in 2019, the SEC did not include private equity fund advisers among its 2019 Examination Priorities. Do you know what the rate of misconduct is today? Is there a reason the SEC doesn't consider private equity fund advisers a priority?**

There are approximately 1,700 registered investment advisers (RIAs) that manage private equity funds. Retail investors have exposure to many of these funds, including through their interests in pensions, charities and endowments, among other arrangements. OCIE examines all advisers—including private equity advisers—on a risk basis. Examining RIAs to private funds is a priority for OCIE, as noted in the 2020 National Exam Program Examination Priorities.

OCIE continues to focus on RIAs to private funds that have a greater impact on retail investors, such as firms that provide management to separately managed accounts side by side with private funds. Moreover, OCIE will review RIAs to private funds to assess compliance risks, including controls to prevent the misuse of material, non-public information and conflicts of interest such as undisclosed or inadequately disclosed fees and expenses, and the use of RIA affiliates to provide services to clients. Following completion of an examination, OCIE issues a report to the adviser that includes observations, recommendations and findings concerning the entity's compliance practices. OCIE has observed that many private equity fund advisers have upgraded their compliance practices in response to comments and findings identified by OCIE. Where appropriate, over the years OCIE has on many occasions—and will continue to—refer conduct to the SEC's Division of Enforcement.

**23. The Consolidated Audit Trail, or the CAT, is the repository that will allow regulators to track trades from their inception, and pinpoint buyers, sellers, exchanges, and brokers. This important oversight and enforcement tool was proposed in 2010 and adopted through Rule 613 in 2012. However, the CAT is not slated to be implemented until 2022—12 years after it was proposed and a decade after the adoption of Rule 613. What is taking this critical project so long and can you guarantee its speedy implementation?**

**Answer:**

The CAT remains a key initiative that is intended to enhance regulatory oversight of our securities markets. In July 2012, the Commission adopted Rule 613 of Regulation NMS, which requires the SROs to jointly develop and submit to the Commission a national market system (NMS) plan to create, implement and maintain the CAT. The SROs filed the CAT NMS Plan in 2015, and the Commission approved the CAT NMS Plan in 2016. The CAT NMS Plan set forth deadlines for the CAT's implementation beginning in November 2017.

Progress on the CAT, however, was much slower than anticipated. As I testified to last year, the SROs failed to meet a number of required and self-imposed implementation and reporting deadlines since the Commission approved the CAT NMS Plan in 2016. Given these delays and recognizing various deficiencies in the CAT NMS Plan, Commission staff has been engaging with the SROs with a focus on trying to ensure that project management, resource, and

governance deficiencies are addressed, including development of comprehensive work plan with milestones. In addition, at the beginning of 2019, I appointed a senior-level staff person to coordinate the Commission's efforts to monitor the development of the CAT.

The SROs have made some positive changes to address these deficiencies, including the development of a Master Plan with projected implementation milestones and the appointment of a leadership team that appears to be working cooperatively toward achieving solutions. Also, at our urging, the SROs increased the role of Advisory Committee members and other industry representatives in the implementation process. Another notable change since last year is that in February 2019, the SROs transitioned from Thesys Technologies, LLC as the plan processor to FINRA CAT. To date, implementation of the CAT is still not complete, and the SROs project completion in 2022.

To reduce the likelihood of further unnecessary or unanticipated delays in the implementation of the CAT and to increase the transparency of the implementation process for market participants who must bring their systems into compliance with CAT, in May 2020, the Commission adopted amendments to the CAT NMS Plan to require the SROs to file with the Commission and to make publicly available an implementation plan and quarterly status reports. The amendments also establish provisions that are designed to introduce financial accountability in order to help ensure the SROs meet certain CAT implementation milestones in a timely fashion.

At this time, a range of broker-dealers are actively testing and refining their ability to report to CAT. COVID-19's impact on market participants, including necessitating SROs and broker-dealers to implement their business continuity plans, has placed stress on their information technology infrastructure and required the deployment of significant resources, including to implement and adapt business continuity plans. To allow firms to maintain focus on operational readiness and reduce operational risk, SEC staff has issued a no-action letter regarding the SROs' enforcement of their CAT compliance rules through May 20, 2020 so that personnel who are working on CAT matters but are important to maintaining critical operations and implementing business continuity plans can focus their attention on those immediate needs. On April 21, the Commission approved an exemptive order establishing phased CAT reporting timelines for broker-dealers with the first industry member milestone set for June 22, 2020. I remain committed to establishing a fully operational CAT and believe it is important that CAT implementation becomes a reality.

**24. You recently said that you don't expect cryptocurrency to be traded on an exchange until it is "better regulated." What type of regulations do you envision are necessary for a cryptocurrency to be listed on one of the regulated securities exchanges? Is the SEC planning on introducing any of these regulations?**

**Answer:**

Electronic platforms have become a popular means for investors to buy and sell digital assets, including coins and tokens offered in ICOs. Many such platforms refer to themselves as "exchanges," which implies a robust regulatory regime that is typically not present for these

platforms. This is a real concern because a significant number of these platforms trade digital assets that likely meet the definition of a security. To put it simply, a platform that operates as an “exchange,” as defined by the federal securities laws, for trading securities must register as a national securities exchange or operate under an exemption from exchange registration—for example by registering as a broker-dealer and complying with Regulation ATS. The failure of a platform trading securities to register as a national securities exchange or to operate under an exemption from exchange registration would be a violation of the federal securities laws even where the securities at issue are in digital form, like coins and tokens.

With respect to trading platforms, SEC staff has provided its views through two public statements.<sup>5</sup> These statements, among other things, asked entities facilitating the trading of digital asset securities to carefully consider the totality of their activities and functionalities to determine whether they meet the definition of an exchange; outlined the Commission’s functional approach to the regulation of platforms and other intermediaries trading digital assets; highlighted concerns that many online trading platforms appear to investors as SEC-registered and regulated marketplaces when they are not; and provided questions investors should ask before using the services of an online trading platform.

I understand that a number of market participants are seeking to engage in activities involving digital assets as investment advisers, funds, exchanges, broker-dealers or ATS operators. Those activities include advising on investments, acting as placement agents, engaging in secondary market trading and acting as custodians for retail or institutional clients, among others. We must bear in mind that these types of activities are regulated under our securities laws in order to provide important market and investor protections. We must also recognize that distributed ledger technology is nascent and rapidly evolving.

With respect to custody, in July 2019, the staff of the Division of Trading and Markets and FINRA staff issued a joint statement articulating a number of considerations relevant to the application of the federal securities laws to custody of digital asset securities, including a number of compliance considerations for broker-dealers seeking to custody digital asset securities. Further, the staff of the Division of Investment Management issued a letter in March 2019 seeking public input on digital asset custody issues affecting investment advisers’ clients, including: (1) challenges investment advisers face with respect to the custody of digital assets; (2) auditing issues; (3) the settlement process; (4) how concerns about misappropriation can be addressed; and (5) to what extent distributed ledger technology can be used more broadly for purposes of evidencing ownership of securities. The staff stands ready for further engagement with interested parties on operating in a manner compliant with the U.S. federal securities laws.

**25. You have recently stated that there’s no reason why securities laws as they stand shouldn’t apply to initial coin offerings and tokens, saying that while you’re generally not in the law-expansion business, you’re also “not in the head-sticking-in-the-sand business either.”**

- a. How is the SEC currently applying securities laws to regulate cryptocurrencies?
- b. As they currently stand, do you think securities laws adequately protect investors from the risks posed by cryptocurrencies?

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<sup>5</sup> Link to statements

**Answer:**

Determining whether a transaction involves a security does not turn on labelling—such as characterizing a digital asset as a “utility token” or “stablecoin”—but instead requires an assessment of the facts and circumstances, including the economic realities underlying a transaction. Generally, we look at whether the digital asset fits the definition of a security as set forth in the federal securities laws, which define “security” broadly. Digital assets that incorporate features and marketing efforts that emphasize the potential for profits based on the entrepreneurial or managerial efforts of others contain the hallmarks of a security under U.S. law.

Many ICOs that I have seen promoted involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws. Many token offerings I have seen appear to be capital raisings with all of the traditional hallmarks of selling a security.

In April 2019, FinHub published a framework for analyzing whether a digital asset is offered and sold as an investment contract, and therefore, is a security. The framework explains how certain facts, if present, create a greater likelihood of satisfying elements of the *Howey* test. On the other hand, the framework also provides examples of characteristics that, if present, would make it less likely that a digital asset is a security, as well as an example of a digital asset that would not be an investment contract.

Additionally, the Division of Corporation Finance (Corporation Finance) has issued two no-action responses to market participants, indicating that the staff would not recommend enforcement action to the Commission if the digital assets described in the requests are offered or sold without registration under the U.S. federal securities laws. Corporation Finance has also qualified two offering circulars for initial coin offerings pursuant to Regulation A, which demonstrates the SEC’s commitment to working with entrepreneurs seeking to conduct ICOs in compliance with the federal securities laws. The staff continues to evaluate filings relating to other digital assets and evaluate requests for no-action relief and stands ready to work with market participants to resolve the complex issues that arise in this context. Further, as I have previously discussed in detail, the SEC’s FinHub serves as a resource on these and other FinTech-related issues and facilitates engagement with investors and market participants.

Technological innovations in the financial industry have the potential to transform how the securities industry operates. ICOs, when conducted in compliance with the federal securities laws, can provide promising and novel means to help facilitate capital formation. Regardless of the promise of such technology, however, a number of concerns have been raised regarding the ICO markets, including that, as they are currently operating, there is substantially less investor protection than in our traditional securities markets, with correspondingly greater opportunities for fraud and manipulation.

The SEC has been consistent in its messaging to market participants that those who use ICOs to raise capital or to engage in securities transactions must comply with the federal

securities laws, and through enforcement actions, has vigorously pursued those who do not comply with our laws or commit fraud. In addition, we have sought to educate Main Street investors concerning the heightened risk profile associated with investments in ICOs. For example, we have warned that the SEC and other market regulators may not be able to effectively pursue bad actors or recover funds when ICO markets span national borders and that there are significant security risks due to the potential for hacking online trading platforms and individual digital asset wallets.

**26. You often talk about an experience that you call your “Acela moment.” Can you please tell the Committee about your Acela moment and how it highlights the need for cryptocurrencies to be sufficiently regulated in order to protect investors and prevent fraud?**

**Answer:**

On one of my train trips between Washington, DC, and New York City, I overheard an individual speaking loudly into his cell phone discussing a digital asset he was promoting, with no regard for investors or our securities laws. This experience reinforced for me the need for the SEC to be actively policing the markets for unlawful activity and educating Main Street investors about the risks and fraud associated with these products.

A number of concerns have been raised regarding the cryptocurrency and ICO markets, including that, as they are currently operating, there is substantially less investor protection than in our traditional securities markets, with correspondingly greater opportunities for fraud and manipulation. An opportunity often exists to perpetrate fraudulent investment schemes by touting an ICO investment opportunity as a way to get into a cutting-edge space, promising high investment returns. Also, it is relatively easy for anyone to use blockchain technology to create an ICO that looks impressive, even though it might actually be a scam. In 2018, the SEC’s Office of Investor Education and Advocacy did so with its HoweyCoin page, which it created quickly with few resources.

ICO markets span national borders and significant trading may occur on systems and platforms outside the United States. Invested funds can quickly travel overseas without the investor’s knowledge. As a result, risks can be amplified, including the risk that market regulators, like the SEC, may not be able to effectively pursue bad actors or recover funds.

Even if not fraudulent, ICOs that are securities might not comply with registration requirements. It is important that any ICO that involves an offer of securities be accompanied by important disclosures, processes, and other investor protections that the federal securities laws require.

**27. Facebook is advertising to consumers and investors that its planned global cryptocurrency, Libra, is 100% “backed” by a basket of “low-risk” currencies and government-backed securities, and that this basket will be managed to keep up with demand. Many experts have observed that this looks an awful lot like an exchange traded fund (ETF), an investment product that, as you know, is regulated by the SEC.**

**Chairman Clayton, can you please describe the characterizes of an ETF? Do you believe that Libra, as described, shares many of the characteristics of an ETF?**

**Answer:**

An ETF is an investment company registered under the Investment Company Act of 1940. The first question is whether the pool meets the definition of “investment company,” which depends on the nature of the pool’s assets and how it holds itself out to the public, among other things. If the pool is an investment company and is properly registered, to operate as an ETF it must also meet certain conditions, such as those relating to portfolio transparency, certain website disclosures (including the ETF’s bid-ask spread) and that the ETF be listed on an exchange.

Some of the characteristics of an ETF include: (1) ETFs do not sell or redeem individual shares and instead authorized participants that have contractual arrangements with the ETF (or its distributor) purchase and redeem ETF shares directly from the ETF in blocks called “creation units”; (2) an authorized participant that purchases a creation unit of ETF shares directly from the ETF deposits with the ETF a “basket” of securities and other assets identified by the ETF that day, and then receives the creation unit of ETF shares in return for those assets; (3) investors can buy or sell their shares throughout the day in the secondary market at a market-determined price; and (4) each share of an ETF represents an undivided interest in the underlying assets of the ETF.

The SEC will continue to examine the Libra project as it develops and to evaluate the federal securities laws implications that it could present. Given the evolving nature of the project, it would be premature to reach any conclusions as to the application of the federal securities laws to the Libra project.

**28. The President of the Financial Action Task Force recently warned that “the anonymity afforded by digital assets is already being exploited by criminals.” Can you please tell the Committee how digital coins like Libra can be used to launder cash and finance terrorism? What is the SEC doing to combat this? What tools do you need from Congress to help prevent digital assets, like Libra, from being used in illicit and terrorist financing?**

**Answer:**

Fundamentally, we must maintain the integrity of our markets and protect them from abuse. Without commenting on any particular product, I agree that digital assets generally pose money laundering and other illicit financing risks. I am concerned about the growing use of digital assets—particularly the development of new digital assets designed to enhance anonymity—to facilitate illicit activity, including securities fraud, money laundering, and other unlawful activities.

In the United States, financial institutions, including broker-dealers, have AML/CFT obligations under the Bank Secrecy Act (BSA), including a requirement to establish an effective

AML program, to conduct due diligence on their customers, to monitor transactions for suspicious activity, and to report that suspicious activity under many circumstances. These obligations exist regardless of whether the financial institution is engaged in activities involving currency, funds or value that substitutes for currency—including digital assets and virtual currencies. On October 11, 2019, the CFTC, FinCEN and the SEC issued a joint statement reminding persons engaged in activities involving digital assets of their AML/CFT obligations under the BSA.

While the United States regulates, supervises and takes enforcement actions related to digital asset activity, the lack of consistent AML/CFT regulation of digital assets across international jurisdictions exacerbates its illicit financing risks. Consistent and effective AML/CFT regulation and supervision by all jurisdictions for relevant digital asset businesses are vital for combating the abuse of digital assets and are a significant factor in promoting safe and responsible innovation in the financial sector. I believe countries should act in accordance with the FATF standards.

**29. Facebook plans on giving Libra to new users who open new accounts with their Calibra wallet. If these anonymous digital assets end up being used to finance terrorist activity or other illicit activity, can Facebook or the Libra Association be held liable for money laundering or terrorist financing?**

**Answer:**

Without commenting on any particular product, as part of effective AML/CFT supervision and risk mitigation for digital assets, both domestic and foreign criminal and civil enforcement actions play a key role. International and interagency cooperation and collaboration are an important part of the supervision and regulation of digital assets, the prosecution of illicit activity involving digital assets and the mitigation of the risks associated with them. While the United States regulates, supervises and takes enforcement actions related to digital assets activity, the lack of consistent AML/CFT regulation of digital assets across international jurisdictions exacerbates its illicit financing risks.

Prosecution of money laundering or terrorist financing crimes are beyond the remit of the SEC. I defer to the Department of Justice as I understand it is primarily responsible for this area.

**30. Despite data proving that diverse companies perform more successfully, we still find that the financial services industry is largely white and male at its highest levels. The same can be said for government regulators such as the SEC where minorities comprise only 24% of senior officer positions and women comprise only 39%. What more can you do as Chairman to incentivize diversity and equity within your agency? What are you doing to encourage diversity and equity at the firms you regulate and supervise? Please be specific about tangible steps that you and your staff are currently taking and considering.**

The SEC is firmly committed to advancing diversity, inclusion and opportunity within agency leadership and the workforce. We promote these just and value-enhancing principles on

many fronts both within the SEC and through our outreach to market participants, including our outreach to Main Street investors and historically underrepresented communities.

Regarding efforts to promote diversity and equity within the SEC, I believe promoting diversity, inclusion and opportunity in our workplaces and more generally is not only a shared societal obligation, it also is value-enhancing. At the SEC, an agency that is human-capital driven, I believe our efforts have provided tangible proof of this value proposition. When I first testified before this Committee in 2017, I stated that while we have improved the diversity of our workforce more generally, increasing the diversity in the SEC's leadership ranks was an area for improvement that was front of mind for me. Today, over half of the divisions and offices that report to me are led by women, and recent appointments have increased the racial and ethnic diversity in our senior roles. However, more work continues and needs to be done, especially to ensure that we build a strong and diverse pipeline of professionals to fill supervisor and senior officer positions as they become available.

In this regard, I am pleased to chair the SEC's Diversity Council and sponsor three of our staff affinity groups: (1) the African American Council; (2) the Hispanic and Latino Opportunity, Leadership and Advocacy Council; and (3) the Veterans Committee. The Diversity Council and our affinity groups are focused on identifying both internal and external candidates for positions at the SEC, as well as ensuring that our work environment facilitates the development of all employees. It is important to me that this work filters through and becomes part of the fabric of the Commission. I believe one method to raise consciousness regarding these issues and the individual and organizational challenges we face is for senior leaders of an organization to demonstrate their consciousness. At the SEC, one way we have done this is through agency-wide events. During my tenure, I have led several such events, including: (1) a roundtable discussion on unconscious bias; (2) a discussion with Dr. Henry Louis Gates and Glenn Hutchins on the insidious nature of discrimination and its lasting effects on our society; (3) a series of panels with SEC first-generation professionals discussing their experiences and sharing advice; (4) a fireside chat with then-Treasurer of the United States Jovita Carranza on the challenges she has faced and overcame in her career and how to mentor future leaders, including in particular women and persons of color; and (5) a candid discussion with Harold Ford, Jr. and Rusty O'Kelley on topics related to professional development, as well as diversity and inclusion in the financial services industry.

The SEC's Office of Minority and Women Inclusion (OMWI) Director Pam Gibbs has been instrumental in our efforts to promote diversity, inclusion and opportunity at the SEC. Pam and I have worked together closely throughout my tenure. Through OMWI's leadership, we are working to finalize our first Diversity and Inclusion Strategic Plan, which will help guide how the agency will continue to promote diversity, inclusion and opportunity within our workforce, as well as with respect to supplier relationships and the entities we regulate. This plan will include measureable actions and envisions that SEC leadership, managers and supervisors in all divisions and offices will take ownership on its implementation as a key part of their ongoing commitment to improving our workforce and performance. This plan has been informed by conversations with SEC staff across our divisions and offices (including regional offices), our employee affinity groups and the Diversity Council, as well as external parties, and we look forward to publishing this plan in the near future.

To help further OMWI's efforts, recently I asked Robert Marchman to serve as the Commission's first Senior Policy Advisor on Diversity and Inclusion. Mr. Marchman is a distinguished professional and has a demonstrated history of adding value to organizations on many levels, including through his leadership in diversity and inclusion. In this new role, Mr. Marchman is responsible for developing and implementing strategies to promote diversity and inclusion, both within the SEC's divisions, offices and advisory committees and through external engagement with agency partners and market participants,<sup>6</sup> and he has already made a positive impact in many areas.

While we have made progress at the agency, a number of significant challenges still remain. For example, in many cases, openings in important leadership positions do not occur frequently, and when openings do occur, there often is an acute need to fill them quickly with persons who have identified skills and expertise. As a result, I have made it clear that, when these positions do become available: (1) we must have a diverse pool of talent ready to take the next step, and (2) applicants must be, and must feel they have been, treated fairly. To help achieve these goals, we have held a number of agency-wide town halls and roundtables. I have led candid discussions on unconscious bias and the importance of mentoring, and I recently held an agency-wide town hall on the importance of our human capital, with a focus on diversity, inclusion and opportunity.

As we look forward in the area of hiring, with the lifting of the hiring freeze in FY 2019 and the funding for new positions Congress gave us in FYs 2019 and 2020, I am confident we can continue to improve the Commission's hiring processes and diversity profile. In FY 2019, at my direction, OMWI and OEEO held discussions with hiring managers after the hiring freeze was lifted to emphasize the importance of diversity and inclusion, and an overall tone of fairness, in the hiring process. In order to expand the SEC's recruitment pipeline, OMWI participated in nearly 30 workforce diversity events in FY 2019 and partnered with 270 minority and women recruitment sources to help ensure SEC job advertisements reach diverse applicants. These hiring process efforts will continue in FY 2020.

In addition to promoting a culture of diversity, inclusion and opportunity at the SEC, we are also looking to the industry we regulate to be leaders in promoting opportunities for historically underrepresented populations within their workforces.<sup>7</sup> We have conducted significant outreach in this regard. For example, in 2018 and again in 2019, the SEC helped organize and participated in the Financial Regulatory Agencies' Diversity and Inclusion Summit. Additionally, the SEC has partnered with high-minority high schools, women's colleges and historically black colleges and universities (HBCUs) to promote increased exposure to careers in business, finance and law, as well as the importance of financial education. More recently, we have increased our focus on the participation of minority and women-owned asset managers in the management of public and private retirement funds. We have commenced several initiatives

<sup>6</sup> See Press Release 2019-273, SEC Announces Robert A. Marchman as Senior Policy Advisor on Diversity and Inclusion (Dec. 19, 2019), available at <https://www.sec.gov/news/press-release/2019-273>.

<sup>7</sup> See SEC Chair Clayton on Diversity and Inclusion, Remarks before the SIFMA Compliance and Legal Society Annual Seminar, available at <https://www.youtube.com/watch?v=5dVwunJ8jwM>.

to better understand and, to the extent appropriate, help address imbalances in these areas. I would be happy to discuss these plans with you as they continue to develop.

I believe our increased focus on diversity in the financial services industry and the related value-enhancing proposition it entails is a positive step forward. Again, I also recognize that our efforts in this area must also be lasting and tangible, and there is more we can do. In 2018, the SEC launched its first-ever Diversity Assessment Report and communicated directly with approximately 1,300 of the largest SEC-registered firms to encourage responses. While I am told that the 38 firms that responded represent almost half of the employees in the securities and investment industry, the results in terms of total firm participation are disappointing. This is an area where we can do more, and I anticipate we will take additional steps to incentivize participation in this initiative, including through the work of Mr. Marchman.

Additionally, over the past few years, we have also been working to improve the Commission's outreach to investors and entrepreneurs of all backgrounds and experiences so they are aware of the ways that they may benefit from America's dynamic markets. For example, this past year, led by the SEC's new Office of the Advocate for Small Business Capital Formation, the SEC and Morehouse College hosted an event for minority entrepreneurs and investors in Atlanta that provided an opportunity for these businesses to share their success stories, as well as highlight improvements that can be made to support more diverse small business capital formation.<sup>8</sup> As part of a new initiative, the SEC Commissioners and I have worked closely with our Office of Investor Education and Advocacy (OIEA), OMWI and our regional offices to promote participation at several investor roundtables, including Investor Town Halls in Atlanta, Georgia; Chicago, Illinois; and Baltimore, Maryland, as well as a similar event in St. Louis, Missouri. I participated directly in these town halls, taking questions in a wide variety of areas, including the consequences of opportunity in our markets being too narrowly distributed, and financial literacy being both much lower than it should be and also too narrowly distributed. We worked with local organizations and educational institutions that typically serve women and communities of color in order to ensure broad participation in these conversations. The conversations were incredibly informative for both SEC personnel and retail investors, due in part to the diverse set of experiences and opinions at the table. I expect these types of town halls to continue this year.

These are just a few of the ways the SEC has been working to promote diversity, inclusion and opportunity, and I am happy to continue discussing this important issue with you, including additional ideas for improvement both at the Commission and more broadly. In addition, we welcome the opportunity to work with Congress on local financial education and outreach events.

**31. As you know, the SEC's money market mutual fund (MMF) reform rules went into effect nearly 3 years ago so that now all MMFs, except government MMFs, would be able to impose liquidity fees on investors or to temporarily suspend investor redemptions if their level of weekly liquid assets falls below a certain threshold. In**

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<sup>8</sup> See Atlanta's Entrepreneurs Share their Stories and Expertise, available at <https://www.sec.gov/page/atlantas-entrepreneurs-share-their-stories-and-expertise>.

addition, institutional prime and institutional tax-exempt MMFs are now required to maintain a floating NAV so that their share prices reflect actual market value.

- a. Would you please describe the benefits of requiring these MMFs to float their NAV in terms of reducing risks, increasing transparency, and promoting fairness?
- b. Do you believe that the fees and gates provide the same level of benefits?

**Answer:**

The Commission, in the release adopting the reforms in 2014, expressed concerns that money market funds (MMFs) as they existed could pose risks to investors and the broader markets, especially to the extent their features may have created a first mover advantage that incentivizes investor runs. These risks were brought into focus by the failure of the Reserve Primary MMF during the financial crisis and the accompanying disruption to the short-term funding markets. Accordingly, the 2014 reforms included certain structural reforms designed to mitigate these risks, including a floating net asset value (NAV) for all non-government and retail MMFs designed to address potential first-mover advantages. The reforms also included new liquidity fee and redemption gate requirements, which are tools designed to help MMFs better manage any potential investor run should it occur.

Throughout the two-year compliance period after the reforms' adoption and continuing to date, the staff has closely monitored the implementation of these reforms and reviewed their impact on MMFs and the short-term lending markets. Further, the events in mid-March, to some extent, served as a test of the MMF industry resiliency in light of the 2014 reforms. Despite significant outflows from some prime institutional MMFs, no fund instituted a liquidity fee or gate. However, it must be recognized that actions of other federal regulators and Congress also helped to ease market conditions and, in particular, relieve liquidity pressures in MMFs and more broadly. For example, in mid-March the Federal Reserve established the Money Market Fund Liquidity Facility (MMLF), which was directly helpful stabilizing the funding markets in which MMFs participate. The SEC, both individually and in conjunction with other members of the FSOC, the FSB and IOSCO are reviewing these matters.

**Commissioner Jackson**

1. Last year you gave a speech in which you described rebates as “controversial payments” and expressed enthusiasm for the SEC’s Transaction Fee Pilot which was designed to study on the effects of rebated on market conditions. However, since then, the SEC announced that it is delaying the pilot’s implementation pending the results of a lawsuit brought by the exchanges.
  - a. Can you explain the conflict of interest that arises from allowing exchanges to compensate brokers based on the volume of customers orders sent to the exchange? How would the Transaction Fee Pilot help address these concerns?
  - b. Can you explain the SEC’s decision not to move forward with the pilot? Would the pilot damage the securities markets as the regulators suggest?

- c. The SEC did maintain one aspect of the pilot program, namely the requirement that exchanges collect certain data. When does the SEC expect to start requiring the collection of this “pre-pilot” data?
2. Facebook announced plans to develop a new cryptocurrency, Libra, and a wallet for it to be stored on, Calibra, in June. It has been reported that Facebook did not engage with the SEC or its staff leading up to this announcement, and during his congressional testimony, David Marcus claimed that Libra wouldn’t fall under the agency’s jurisdiction because Libra would operate more like cash than a security, albeit some observers argue that it would operate as an ETF.
  - a. What is your opinion of Libra?
  - b. What steps do you think Congress should be taking?
3. Is Congress right to be concerned that the size of the private marketplace exceeds the public marketplace? How would you characterize the protections that current exist in the private placement marketplace for retail investors? Are they adequate?
4. We continue to have a significant lack of information about the private marketplace. Even figures like \$3 trillion in private markets are, by the SEC’s own admission, merely an estimate. Given this lack of information, and the corporate governance and valuation problems of privately-held companies, as recently highlighted by WeWork, it is concerning that the SEC is looking to push more retail investors into highly risky and speculative private placements; investments that do not appear to be in retail investors’ “best interest.”
  - a. Shouldn’t the SEC be more focused on getting basic information about private markets before they consider such fundamental changes to those markets and putting Main Street investors at risk?
5. SEC penalties are currently limited to a maximum of \$181,071 per offense and institutions to \$905,353.
  - a. Given the extraordinary dollar amounts these violations can involve and the magnitude of the effects they can potentially have on families, do you believe that the current penalty amounts adequately penalize violators and discourage recidivism, or do you believe that they are so low that companies view them as just another cost of doing business?
  - b. Would you support enhancing the SEC’s penalty authority as the Stronger Enforcement of Civil Penalties Act does?
6. Unlike the SEC, PCAOB disciplinary reviews and proceedings are conducted in secret. Senator Grassley recently stated that “this secrecy provides incentives to bad actors to extend the proceedings as long as possible so they can continue to do business without notice to business about potential problems with a particular auditor.” He pointed to a situation in which an accounting firm that was subject to a disciplinary proceeding issued 29 additional audit reports on public companies without any of those companies knowing about the ongoing PCAOB disciplinary proceedings. Testifying before the Senate Banking Committee, Former PCAOB Chairman James Doty himself said that

this lack of transparency “is not good for investors, for the auditing profession, or for the public at large” and that “investors would be best served by similar transparency in PCAOB disciplinary proceedings.”

- a. Do you believe that the secret nature of PCAOB proceedings creates risk for the market and investors? Do you see a reason to treat PCAOB disciplinary hearings differently from SEC enforcement proceedings?
7. There is great concern that financial institutions have received waivers of bad actor disqualifications even after they have engaged in repeat criminal offenses. For instance, in 2009, DOJ entered into a deferred prosecution agreement with UBS for aiding and abetting tens of thousands of US citizens in evading US taxes. The SEC then provided UBS with a waiver to continue business as usual. Less than two years later, DOJ entered into a non-prosecution agreement with UBS for rigging bids to reinvest the proceeds of bond offerings by communities, community organizations, and other non-profits. Again, the SEC granted UBS a waiver. A year later in 2012, DOJ entered into another non-prosecution agreement with UBS for manipulating the LIBOR, one of the most widely used global interest rate benchmarks, and UBS received an astonishing 5 waivers from the SEC. These waivers were explicitly conditioned on compliance with the non-prosecution agreement negotiated with DOJ. Yet, in 2015, DOJ concluded that UBS breached the LIBOR non-prosecution agreement by conspiring with other financial institutions to manipulate foreign exchange rates, resulting in UBS pleading guilty to wire fraud in connection with its efforts to manipulate benchmark interest rates. UBS again received 5 waivers from the SEC even though it had admitted to committing felonious criminal conduct.
    - a. This is extraordinary. Under what circumstances do you think the SEC should deny waiver requests? Do you believe that requiring the SEC to engage in a more public, transparent process could encourage the agency to be more selective in who it grants waivers to, leading them to be the exception rather than the rule?
  8. Aside from the waiver process under Section 9(c) of the Investment Company Act of 1940, no other SEC waiver process allows the public to provide input on whether an applicant should receive a waiver of a bad actor disqualification. This means that only after extensive ex-parte communications between the SEC and financial institutions does the public learn of the unlawful conduct committed by financial institutions, the harm the misconduct caused, and the fact that the disqualifications that were supposed to be levied against the financial institution were waived. The SEC sometimes even comments on applicants’ waiver request applications and allows the applicant to resubmit the application. The records of these discussions, including the issues that the agency identifies as important, the case that the financial institution made when seeking a waiver, and how the financial institution’s petition changed over the course of those discussions, are not available to the public.
    - a. What issues arise from keeping this process secret from the public and do you believe that we should require that this process be conducted publicly and with public input? Does the SEC’s newly announced waiver process adequately address these transparency issues?

9. The Committee on Financial Services would like to ask you about the Insider Trading Prohibition Act authored by Representative Himes. U.S. District Judge Jed Rakoff argued in 2015 that “if unlawful insider trading is to be properly deterred, it must be adequately defined. The appropriate body to do so, one would think, is Congress.” And even the late Justice Scalia argued that “only the *legislature* may define crimes,” and that Congress shouldn’t leave the job of defining insider trading to the courts. Can you talk a little bit about why it’s important for laws that have criminal consequences to be clearly defined by statute? What are the benefits to the SEC — and to investors — of Congress codifying insider trading law?
10. As you know, SEC rules give public companies 4 days to disclose significant corporate events on a Form 8-K. And sometimes companies actually *need* 4 days to prepare the filing — it might take 4 days to distill a complicated merger announcement, or summarize a new supplier agreement. So, there are legitimate reasons for this 4-day gap between the occurrence of a significant event and the filing of an 8-K disclosing the event. But is there any reason to allow company insiders to *trade* during this 4-day gap? Wouldn’t it be simpler to just prohibit insiders from trading *at all* during this 4-day gap?
11. According to the Sustainable Investments Institute 2018 report, 78% of the S&P 500 issue issued a sustainability report for the most recent reporting period, most with environmental and social performance metrics. The rate of sustainability reporting for the world’s largest companies is even higher, with some figures noting as high as 93 percent. The Sustainable Investments Institute’s report found 97 percent of reporting companies chose to customize their own sustainability reporting models—in style, format and content—instead of closely following any one framework. Given these discrepancies, do you think investors would benefit if this data was easily comparable?
12. T. Rowe Price noted in its 2018 proxy voting guidelines that “boards lacking diversity represent a suboptimal composition and potential risk to company’s competitiveness over time.” Similarly, over 90 percent of companies that participated in Deloitte’s 2017 board diversity survey agreed that increased board diversity will improve their companies’ ability to innovate as well as their overall business performance. After analyzing the performance of approximately 90 U.S. bank holding companies, two federal reserve economists also concluded that banks with more gender diversity on their boards (those with a female share of about 13 to 17 percent) perform better. Moreover, they suggested that “banks’ continued voluntary expansion of board gender diversity is likely to bring performance benefits, provided that the banks are well-managed or capitalized.” With the results of these studies in mind, do you think investors would find information about board diversity valuable?
13. Do you agree that a company’s investment in human capital is critical information for investors and that they are disadvantaged when they are not provided with this information? Why?

14. On April 10<sup>th</sup> you co-authored an op-ed in the Wall Street Journal with MIT Sloan School of Management Senior Lecturer Robert C. Pozen entitled “Executive Pay Needs a Transparent Scorecard.” Explain to the Committee the problem you have identified with the executive pay metrics disclosed in public company proxy statements? And what should the SEC or Congress do to fix the problem?
15. You have written extensively on the issue of corporate political spending. In fact, in 2011, you co-chaired a committee that studied the issue in-depth and petitioned the SEC to develop rules to require public companies to disclose their political spending. This rulemaking petition received widespread popular support and over 1.2 million comments—more comments than any other petition in the SEC’s history. Why did the committee recommend mandatory disclosure of corporate political spending? Why do you think so many investors find this topic so important?
16. When the Supreme Court decided *Citizen’s United* and opened the floodgates to unlimited political spending by corporations, they stated that the Court did not need to restrict political spending by corporations because abuses could easily “be corrected by shareholders through procedures for corporate democracy.” Of course, what the Court failed to recognize is that public companies are not required to disclose the money they spend on politics, so unless a company voluntarily discloses their corporate political spending, investors have no way of knowing if their money is being spent on politics. Can you please explain how the lack of required disclosure hinders shareholders’ abilities to make informed investment decisions and prevents them from holding the companies they’re investing in accountable?
17. As part of its rulemaking package issued in June on the standard of care owed by investment professionals to their retail clients, the SEC, among other things, established the Form CRS relationship summary which is intended to ensure that investors are informed about the firm’s services and practices and the differences between investment advisers and broker-dealers. The Committee is pleased that the SEC engaged in investor usability testing of its proposed Form CRS. The SEC conducted a nationwide survey of 1,800 individuals, the vast majority of which believed that the form would “help them make more informed decisions about investment accounts and services.” However, when the SEC dove a little deeper and interviewed 31 individuals, the SEC found that “there were areas of confusion for participants, including differences between types of accounts or financial professionals.” Do you believe investor testing by the SEC is or can be effective in understanding and enhancing the quality and transparency of investors’ relationships with investment advisers and broker-dealers?
18. What are your thoughts on what can be done to make the Staff’s Rule 14a-8 no-action process work more efficiently so that that staff can continue to produce written answers in each case?
19. Rule 14a-8 currently gives investors of all sizes the ability to engage with the companies they own on issues that investors see as important to the long-term value of their investments. The current ownership threshold offers a small shareholder the

opportunity to file a resolution with a modest \$2,000 worth of shares that she has held for one year. The SEC announced that it is considering raising this threshold.

- a. How does increasing this threshold help small investors wanting to raise issues with companies when the increase is intended to exclude them?
  - b. Do you believe that only the biggest, wealthiest investors have productive ideas to help companies succeed and operate well? If not, does it make sense to disadvantage the Mainstreet small individual investor?
20. Some proponents of limiting shareholder proposal rights have claimed that many such proposals are esoteric, politically driven and raised by special interests and not relevant to the financial success of a company. Do you believe an issue like climate change, diversity in the workplace, or good governance is an “esoteric” issue?
21. You have spoken on a number of occasions about the problems created by public companies with dual class stock structures with unequal voting rights. Can you explain your concerns about dual class stock companies? What can or should Congress or the SEC do to address these concerns?
22. Stock buybacks are viewed as a capital allocation decision where a company repurchases its own stock when it feels it is undervalued. However, a study that you authored found that twice as many company insiders sold their company shares in the eight days after a buyback announcement compared to an ordinary day. In fact, your study found that corporate insiders sold up to five times more stock immediately following a buyback announcement.
- a. So, if a company is telling the market that it believes its shares are undervalued, why would its executives decide to sell?
  - b. Are there currently any SEC rules that discourage corporate executives from utilizing stock buybacks in this way?
  - c. Does this sort of activity diminish the purpose of compensating executives with company stock—which is to tie corporate pay to long-term performance and health?
23. A recent CNBC analysis found that the companies in the S&P 500 that engaged in the most buybacks relative to their market capitalizations underperformed in the long-term compared to their peers who didn’t engage in the practice. In fact, a paper published in 2016 in the Journal of Corporate Finance came to the conclusion that “managers increase share repurchases when market returns have declined and seem likely to decline further because the company is about to experience a substantial decline in profitability.” It is important to note that stock buybacks were illegal until 1982 precisely because they were viewed as a form of stock price manipulation. Are you concerned that stock buyback programs can be used to manipulate markets and investors by artificially inflating a company’s share prices especially when executives’ compensation depends on the buyback?
24. Many have criticized stock buybacks for disproportionately benefiting investors and executives in the short-term, while workers—those who are actually creating a

company's excess profits—are left in the dust. In fact, companies spent \$1 trillion in stock buybacks last year alone while average worker wages remained flat. A recent Roosevelt Institute study showed that McDonalds could have paid all of its 1.9 million workers almost \$4,000 more a year if it had redirected the money it spent on stock buybacks to worker paychecks instead. Do you believe that companies are engaging in stock buyback programs at the expense of worker wages?

25. In February, the Institutional Limited Partners Association and 35 of its member institutions sent a letter to the SEC asking for stronger regulations of the private equity industry that they largely fund. The statement said that the SEC “has increasingly permitted private equity advisers to limit their fiduciary obligations under the Advisers act by permitting vague, all-encompassing disclosure of conflicts of interest to meet the informed consent requirement.” Has the Commission responded to this letter or the Association's concerns? Do you think the current disclosure regime is functioning as it should to keep Funds accountable to their investors?
26. In 2000, private assets under management totaled less than \$1 trillion. Today that figure exceeds \$5 trillion. Many have attributed this massive increase in the size of private markets to their steady deregulation. For example, in 2010 Congress quadrupled the number of shareholders a private company could have without having to go public from 500 to 2,000 shareholders. The SEC has also adopted rules that encourage private placements at the expense of the public markets. Do you believe the deregulation of private securities markets has impacted the number of IPOs? Can you please discuss why?
27. The SEC in its concept release said that it was difficult to ascertain fraud in the private markets. Why do you think securities regulators struggle with identifying fraud in private markets? Do you believe the current structure of private market exemptions has made it easier for bad actors to engage in fraud?
28. In June, the Commission published a Concept Release advocating for the expansion of the private markets, while also encouraging more companies to go public earlier. If more investors were allowed into the unregulated private markets, wouldn't companies have less, not more incentive to go public? How would you reconcile these seemingly conflicting objectives?
29. Last week the SEC voted 3-2 to finalize deeply misguided amendments to the Volcker Rule, which, as you noted in your dissent, was originally intended to limit banks from taking risky bets and gambling with taxpayer money. Given the role that proprietary trading played in our last financial crisis and the amount of risk that this rollback is expected to create for our financial markets, can you please discuss the evidence and staff analysis that was used to justify this rollback? Do these new amendments incentivize risky behavior at the expense of American investors?

## Commissioner Lee

1. Facebook announced plans to develop a new cryptocurrency, Libra, and a wallet for it to be stored on, Calibra, in June. It has been reported that Facebook did not engage with the SEC or its staff leading up to this announcement, and during his congressional testimony, David Marcus claimed that Libra wouldn't fall under the agency's jurisdiction because Libra would operate more like cash than a security, albeit some observers argue that it would operate as an ETF.
  - a. What is your opinion of Libra?

Answer:

Digital assets present promising opportunities for technological and financial innovation, but also significant questions for regulators in ensuring that they can be deployed in a responsible manner. We know very little about how Libra would actually be structured or operate in practice. Accordingly, as yet I have not formed an opinion on the appropriate regulatory treatment of Libra. Novel financial products like Libra pose questions and challenges for determining whether they might be a commodity, a security, or something else. Where there are questions, I encourage people to work with regulators to consider their proper treatment and regulation.

- b. What steps do you think Congress should be taking?

Answer:

I welcome direction from Congress on this issue, but do not have specific recommendations at this point.

2. Is Congress right to be concerned that the size of the private marketplace exceeds the public marketplace? How would you characterize the protections that current exist in the private placement marketplace for retail investors? Are they adequate?

Answer:

I am deeply concerned about the growing size of the private marketplace relative to public markets. There are very few investor protections in the private markets, and they are designed to cater largely to more sophisticated investors who courts have described as being able to "fend for themselves." One of the principal protections is the accredited investor definition which is intended to help limit the access of private issuers to those investors who are able to both assess and bear the risk of loss in private offerings. However, the wealth thresholds in that definition have not been adjusted for inflation in over 37 years. As a result, the definition has become vastly over-inclusive, capturing investors with little to no ability to assess or bear the risks of private offerings. This presents a significant risk to some of the most vulnerable retail investors that the SEC is charged to protect -- senior investors. An increasing amount of wealth is concentrated in older households because these Americans have spent a lifetime saving for retirement. I am particularly concerned about exposing these hard-earned savings to

investments that we know for certain come with much higher risk and much less transparency about the nature of that risk.

- 3. How does the Commission reconcile their statements in the Concept Release about wanting to encourage more IPOs, but at the same time, expanding the private markets?**

**Answer:**

Those statements are difficult to reconcile. Unprecedented amounts of capital are being raised through private offerings and yet the Commission seeks to further expand alternatives to public markets through, among other things, increasing their access to retail investors

- 4. We continue to have a significant lack of information about the private marketplace. Even figures like \$3 trillion in private markets are, by the SEC's own admission, merely an estimate. Given this lack of information, and the corporate governance and valuation problems of privately-held companies, as recently highlighted by WeWork, it is concerning that the SEC is looking to push more retail investors into highly risky and speculative private placements; investments that do not appear to be in retail investors' "best interest."**
- a. Shouldn't the SEC be more focused on getting basic information about private markets before they consider such fundamental changes to those markets and putting Main Street investors at risk?**

**Answer:**

Yes. I am concerned about efforts to increase private market access to retail investors, and I am particularly concerned that we would consider such changes without adequate data regarding private markets and how they operate. It is critical that our rulemaking be informed and guided by data, rather than by anecdote and intuition. In 2013, the Commission proposed a rule aimed in part at enhancing visibility into the use of Regulation D. That rulemaking was never completed, and our lack of visibility into that market persists. Proposed changes to the exempt offering framework should be preceded by, or at the very least proceed contemporaneously with, efforts such as the abandoned 2013 rulemaking.

- 5. Earlier this month, the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets held a hearing entitled "*Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment*," which considered a legislative proposal entitled "The Private Securities Reform and Transparency Act." The draft bill incorporates a number of reforms that were proposed by the SEC in July 2013 but to date have not been adopted – for example, the bill requires issuers to file Form D prior to commencing public solicitation in a Rule 506(c) offering and requires issuers to also file a closing amendment providing basic information about the offering upon its conclusion. The Committee is very interested in your thoughts on the draft legislation. Would it improve transparency in the private marketplace? Could it assist the SEC and states in policing the marketplace? Does it pose an undue burden on issuers? How**

**much additional work and cost would you estimate these filing requirements would impose on issuers?**

**Answer:**

Yes, I generally support the draft legislation. I would also support the Commission taking up its 2013 rulemaking proposing amendments to Regulation D, Form D, and Rule 156 that was never completed. As noted above, that rulemaking was aimed in part at enhancing visibility into the use of Regulation D. It was also aimed at assessing investor protection concerns related to the then-newly enacted rule permitting issuers to engage in general solicitation under Rule 506(c). Requiring issuers to file Form D prior to commencing a general solicitation and requiring the filing of a closing amendment are simple, commonsense measures that would vastly increase the data we have about this market and therefore better enable us to analyze the market and take appropriate measures to protect investors. In addition, it would provide important information for state securities regulators who form a critical line of defense in protecting against fraud and registration violations in private markets. Form D is a short and simple document. It currently contains approximately 16 fields of basic information about an exempt offering. The filing of this form (which is already required but not always complied with) as well as a closing amendment constitutes a relatively minimal burden which would be outweighed by the significant benefits of enhanced transparency into this market. I also strongly support the provision of the draft bill that specifies that the failure to file Form D would result in the loss of the exemption from registration. The Commission could easily create a provision for waiving the loss of the exemption when it is in the interest of investors and the public to do so. There are already numerous market participants who file a Form D, thus a stronger requirement for filing would only affect those issuers who chose not to comply with the rule.

6. **There is great concern about the SEC's open-ended authority to define the term "qualified purchaser" under the securities laws. When Congress enacted this term and empowered the SEC to define it, Congress could not have imagined that the SEC would employ this authority in such a way that it would encompass "any purchaser," as for example, the SEC defined the term for purposes of its Regulation A+ rulemaking. The Committee is interested in making sure that similar abuses of this discretion do not occur in the future.**
  - a. **Do you share this concern? Is it well-founded?**
  - b. **Do you have any suggestions for how Congress can prevent the SEC from abusing its authority to define "qualified purchaser" in the future?**

**Answer:**

I share your concerns regarding the manner in which the Commission defined the term "qualified purchaser" to include any person to whom securities are offered or sold in a Regulation A Tier 2 offering because such a definition effectively creates no limitation at all. This runs contrary to the views expressed in the legislative history related to the National Securities Markets Improvements Act of 1996 ("NSMIA"), which discussed the term as encompassing "sophisticated investors, capable of protecting themselves in a manner that renders regulation by State authorities unnecessary." H.R. Rep. No. 622, 104th Cong. 2d Sess. at 31

(1996); see also S. Rep. No. 293, 104th Cong. 2d Sess. at 15 (1996). Congress could consider amending Section 18 (15 U.S.C. 77r) to clarify that the term qualified purchaser is meant to include specific limitations.

- 7. SEC penalties are currently limited to a maximum of \$181,071 per offense and institutions to \$905,353.**
- a. Given the extraordinary dollar amounts these violations can involve and the magnitude of the effects they can potentially have on families, do you believe that the current penalty amounts adequately penalize violators and discourage recidivism, or do you believe that they are so low that companies view them as just another cost of doing business?**

**Answer:**

I believe that penalties are often inadequate to deter securities law violations. Compliance is the overall goal of enforcement, and deterrence is central to that goal. Penalties imposed through enforcement actions are intended to deter future violations, and should be calibrated accordingly. Given the size and scale of many issuers and regulated entities, the current penalty structure has unfortunately proven inadequate in many instances as a deterrent against future violations. The continuing frequency and recurrence of violations at the largest financial services firms evidences this and suggests that more needs to be done to improve compliance, including potentially increasing penalty amounts.

- b. Would you support enhancing the SEC's penalty authority as the Stronger Enforcement of Civil Penalties Act does?**

**Answer:**

Yes. As stated above, penalties should be calibrated so as to effectively promote deterrence. I agree that it is important to periodically revisit the basis for penalty calculations to ensure they are adequate to do so. In addition, I welcome efforts to strengthen the Commission's tools to address recidivism among securities law violators, including considering the use of penalties for violations of existing injunctions.

- 8. There is great concern that financial institutions have received waivers of bad actor disqualifications even after they have engaged in repeat criminal offenses. For instance, in 2009, DOJ entered into a deferred prosecution agreement with UBS for aiding and abetting tens of thousands of US citizens in evading US taxes. The SEC then provided UBS with a waiver to continue business as usual. Less than two years later, DOJ entered into a non-prosecution agreement with UBS for rigging bids to reinvest the proceeds of bond offerings by communities, community organizations, and other non-profits. Again, the SEC granted UBS a waiver. A year later in 2012, DOJ entered into another non-prosecution agreement with UBS for manipulating the LIBOR, one of the most widely used global interest rate benchmarks, and UBS received an astonishing 5 waivers from the SEC. These waivers were explicitly conditioned on compliance with**

the non-prosecution agreement negotiated with DOJ. Yet, in 2015, DOJ concluded that UBS breached the LIBOR non-prosecution agreement by conspiring with other financial institutions to manipulate foreign exchange rates, resulting in UBS pleading guilty to wire fraud in connection with its efforts to manipulate benchmark interest rates. UBS again received 5 waivers from the SEC even though it had admitted to committing felonious criminal conduct.

- a. This is extraordinary. Under what circumstances do you think the SEC should deny waiver requests? Do you believe that requiring the SEC to engage in a more public, transparent process could encourage the agency to be more selective in who it grants waivers to, leading them to be the exception rather than the rule?

**Answer:**

In my view, full, unconditional waivers have been granted for misconduct more frequently than the facts have warranted, and this is particularly true when disqualifications were triggered by criminal misconduct. Disqualifications are an important and powerful tool for the protection of investors and markets. They operate to protect those who play by the rules from those who do not. It is important to note that disqualifications are the automatic result of certain securities law violations. Waivers for these automatic disqualifications should only be granted for good cause shown. The Commission should give careful, in-depth scrutiny to every waiver application. It should avoid viewing triggering events in isolation, but rather should thoroughly evaluate an applicant's history of violations to assess whether a firm's recidivism may be the product of deficient controls or a problematic corporate compliance culture.

In addition, the Commission need not make a stark choice between either granting or denying a waiver. The Commission has full authority to, and should, tailor its approach to waiver requests by placing any number of conditions and/or time limitations on waivers, as the facts in a particular case may warrant.

With respect to transparency, the Commission should be held accountable for the waivers it grants. Market participants have the right to information sufficient to understand why the Commission has determined that an automatic disqualification need not apply. Similarly, applicants have the right to information sufficient to understand why a waiver request may not have been granted. Waiver determinations do not occur in open meetings and (whether done by Commission order or through delegated authority) do not lay out the specific reasoning or justifications for the grant. Rather, letters or orders granting waivers refer broadly to the written waiver requests from the violators as demonstrating good cause. There should be greater transparency in this process.

9. **Aside from the waiver process under Section 9(c) of the Investment Company Act of 1940, no other SEC waiver process allows the public to provide input on whether an applicant should receive a waiver of a bad actor disqualification. This means that only after extensive ex-parte communications between the SEC and financial institutions does the public learn of the unlawful conduct committed by financial institutions, the harm the misconduct caused, and the fact that the disqualifications that were supposed**

to be levied against the financial institution were waived. The SEC sometimes even comments on applicants' waiver request applications and allows the applicant to resubmit the application. The records of these discussions, including the issues that the agency identifies as important, the case that the financial institution made when seeking a waiver, and how the financial institution's petition changed over the course of those discussions, are not available to the public.

- a. What issues arise from keeping this process secret from the public and do you believe that we should require that this process be conducted publicly and with public input? Does the SEC's newly announced waiver process adequately address these transparency issues?

**Answer:**

As stated above, waiver determinations do not occur in open meetings and do not lay out the specific reasoning or justifications for the Commission's actions. At a minimum, market participants and applicants should be provided with sufficient information from which they can discern the reasoning behind the Commission's actions regarding waivers of automatic disqualifications. Moreover, I believe there are times when the Commission would benefit from public input in the waiver process, particularly input from those who operate in the same markets as, or may be affected by the future conduct of, these securities law violators.

The waiver process announced on July 3, 2019 laid out a process by which violators may condition their offer to settle an enforcement matter on the granting of a waiver request. However, waiver requests are not evaluated by Enforcement staff, but rather by staff in the Divisions of Corporation Finance and Investment Management. The new policy puts at risk the independence of staff in those divisions to focus their analysis solely on the legal standards set forth in the relevant disqualification provisions. Moreover, it does not increase transparency regarding the waiver process in any way.

10. According to the Sustainable Investments Institute 2018 report, 78% of the S&P 500 issue issued a sustainability report for the most recent reporting period, most with environmental and social performance metrics. The rate of sustainability reporting for the world's largest companies is even higher, with some figures noting as high as 93 percent. The Sustainable Investments Institute's report found 97 percent of reporting companies chose to customize their own sustainability reporting models—in style, format and content—instead of closely following any one framework. Given these discrepancies, do you think investors would benefit if this data was easily comparable?

**Answer:**

Yes. Without a required, uniform framework for sustainability reporting, not all issuers will disclose, the disclosures made may lack reliability, and the specific disclosures will continue to vary greatly by issuer. This will make it difficult for investors to price risk and allocate capital accordingly, and to compare companies on these significant metrics which, as investors have been clear, are aligned with building long-term value.

**11. T. Rowe Price noted in its 2018 proxy voting guidelines that “boards lacking diversity represent a suboptimal composition and potential risk to company’s competitiveness over time.” Similarly, over 90 percent of companies that participated in Deloitte’s 2017 board diversity survey agreed that increased board diversity will improve their companies’ ability to innovate as well as their overall business performance. After analyzing the performance of approximately 90 U.S. bank holding companies, two federal reserve economists also concluded that banks with more gender diversity on their boards (those with a female share of about 13 to 17 percent) perform better. Moreover, they suggested that “banks’ continued voluntary expansion of board gender diversity is likely to bring performance benefits, provided that the banks are well-managed or capitalized.” With the results of these studies in mind, do you think investors would find information about board diversity valuable?**

**Answer:**

Yes. In February 2019, the Division of Corporation Finance issued guidance stating that companies should describe the extent to which they considered a board candidate’s diversity characteristics. I support that guidance, and would also support additional disclosure requirements related to, for example, how public companies identify candidates to fill open board seats, and an expansion of human capital disclosures to cover diversity disclosures related to executives and the broader workforce.

**12. Do you agree that a company’s investment in human capital is critical information for investors and that they are disadvantaged when they are not provided with this information? Why?**

**Answer:**

Yes. There is a growing body of research demonstrating that companies that invest in their workers perform better over time, and a growing consensus among investors that information related to human capital management is material to their investment decisions. Investors have told us through petitions and comment letters that they want the Commission to require the disclosure of key categories of information related to human capital management, including workforce demographics, workforce stability, and workforce compensation and incentives. I was pleased that the Commission, in its recent proposal to update Items 101, 103 and 105 of Regulation S-K, introduced the topic of human capital. But, I hope the final rule will go further by requiring the disclosure of specific metrics so that investors have consistent, reliable, and comparable information on the critical topic of human capital resources.

**13. What are your thoughts on what can be done to make the Staff’s Rule 14a-8 no-action process work more efficiently so that that staff can continue to produce written answers in each case?**

**Answer:**

I think the staff's Rule 14a-8 no-action process provides a critical mechanism through which both companies and shareholders can have greater certainty about the legal basis for excluding a shareholder proposal from a company's ballot. I am concerned that the staff's approach announced on September 6, 2019<sup>9</sup> may lead to fewer response letters, may reduce that transparency and certainty, and may disadvantage shareholders who may be less able to bear the costs of litigation to resolve uncertainty. Given the significance of shareholder proposals to upholding corporate democracy and holding management accountable for its decisions, I support ensuring that staff has adequate resources to devote to the no-action process.

**14. Rule 14a-8 currently gives investors of all sizes the ability to engage with the companies they own on issues that investors see as important to the long-term value of their investments. The current ownership threshold offers a small shareholder the opportunity to file a resolution with a modest \$2,000 worth of shares that she has held for one year. The SEC announced that it is considering raising this threshold. How does increasing this threshold help small investors wanting to raise issues with companies when the increase is intended to exclude them?**

**a. Do you believe that only the biggest, wealthiest investors have productive ideas to help companies succeed and operate well? If not, does it make sense to disadvantage the Mainstreet small individual investor?**

**Answer:**

No, it does not make sense to disadvantage small individual investors. The shareholder proposal process has long provided a vital mechanism for shareholders to communicate their views to, and engage with, management. Indeed, smaller investors have far less ability than larger ones to get the attention of management and prompt management engagement on the issues they deem material to their investments. Larger investors do not have a monopoly on productive ideas about a company's operations, and numerous significant and successful proposals have originated with smaller investors. Increasing eligibility thresholds uniquely singles out retail investor participation, making it more difficult for them to engage with management. The Commission should guard against building structural advantages for wealthier investors into the rule, and instead continue to keep barriers to this process to a minimum so that all shareholders may assist in holding management accountable for their investments.

**15. Some proponents of limiting shareholder proposal rights have claimed that many such proposals are esoteric, politically driven and raised by special interests and not relevant to the financial success of a company. Do you believe an issue like climate change, diversity in the workplace, or good governance is an "esoteric" issue?**

**Answer:**

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<sup>9</sup> See <https://www.sec.gov/corpfin/announcement/announcement-rule-14a-8-no-action-requests>

No, I do not. Investors need information about the risks and opportunities that companies face related to climate change, their policies and procedures related to diversity and good governance, and other issues that they deem material. These risks are not hypothetical; research demonstrates how these risks bear on a company's long-term financial performance. Investors and their advisors are also increasingly vocal about the fact that this information is critical in their decision-making process. The SEC must not substitute its own view for the plainly stated, and well-supported, views of investors as to what is material to their decision making process. The shareholder proposal process provides an important avenue for investors to communicate with the companies that they own about issues that are material to them. And it has proven successful over decades of practice in ushering in valuable corporate reforms such as, for example, the expensing of stock options before this was required by GAAP and non-discrimination policies that include sexual orientation and gender identity.

**16. On August 21st, you and Commissioner Jackson voted against the Commission's "Guidance Regarding Proxy Voting Responsibilities of Investment Advisers" and against the Commission's "Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice." In your statement, you laid out numerous concerns with both guidance, stressing, "...today's release contains new substantive requirements – most notably, increased issuer involvement in the proxy advisory firm's process." Please explain why "issuer involvement" in the fiduciary relationship between shareowners and the proxy advisory firms they hire is inappropriate? How does issuer involvement affect the reliability and independence of proxy advisors' reports?**

**Answer:**

Shareholders and asset managers rely on proxy advisors to provide accurate, well-reasoned and customized advice regarding proposals to be voted on at shareholder meetings. Sometimes that advice includes recommendations that do not align with the views of management. In providing such advice, proxy advisors consider not just factual information, but also the relevant proxy voting policies and preferences that are in their clients' best interests. Clients rightly expect that proxy advisors, in forming their recommendations, will do so in an objective, disinterested manner.

Issuers bring deep expertise and insight into such issues, but also have a clear stake in the outcome and thus a direct conflict of interest when a proxy advisor's recommendation does not align with their own. This type of conflict of interest is handled in precisely the opposite way in analogous contexts, such as in FINRA Rule 2241, which seeks to limit issuer involvement in research provided to investors by analysts. Issuer's views are helpful and necessary to investors in making their voting decisions, but are already easily accessible in management's proxy materials.

**17. In 2000, private assets under management totaled less than \$1 trillion. Today that figure exceeds \$5 trillion. Many have attributed this massive increase in the size of private markets to their steady deregulation. For example, in 2010 Congress quadrupled the number of shareholders a private company could have without having**

**to go public from 500 to 2,000 shareholders. The SEC has also adopted rules that encourage private placements at the expense of the public markets. Do you believe the deregulation of private securities markets has impacted the number of IPOs? Can you please discuss why?**

**Answer:**

Yes, I believe the deregulation of private securities markets continues to undermine the public markets by reducing the comparative benefits to issuers of going public. Private companies now have increasing access to plentiful and relatively cheap sources of capital, with fewer restrictions on general solicitation and greater access to a growing base of accredited investors. These benefits have traditionally been reserved for public markets where greater disclosure is required. However, if companies can access the same or similar benefits in private markets while avoiding greater disclosure, this considerably reduces incentives to go public.

**18. The SEC in its concept release said that it was difficult to ascertain fraud in the private markets. Why do you think securities regulators struggle with identifying fraud in private markets? Do you believe the current structure of private market exemptions has made it easier for bad actors to engage in fraud?**

**Answer:**

The 2019 Concept Release on Harmonization of Securities Exemptions refers to “data limitations” that make it difficult to draw conclusions about the extent of fraud in private markets. (see Concept Release on Harmonization of Securities Offering Exemptions, Rel. No. 33-10649, at 23 (June 18, 2019)). It is the job of securities regulators to identify and protect investors from fraud in private (as well as public) markets. Thus, these data limitations are deeply troubling. They are also, in part, self-imposed. For example, the SEC never finalized a 2013 rule proposal that would have enhanced visibility into private markets by improving, among other things, the nature and extent of information provided on Form D. The data limitations are even more troubling in the context of the obligation to carefully weigh costs and benefits associated with efforts to ease restrictions on and expand private markets. Moreover, private market offerings are subject to far less disclosure and fewer audit requirements than public offerings. Reduced disclosure and audit requirements create enhanced risks of fraud, because it is much more difficult for investors and regulators to identify, investigate and prove fraud when it does occur.

**Commissioner Roisman**

1. Facebook announced plans to develop a new cryptocurrency, Libra, and a wallet for it to be stored on, Calibra, in June. It has been reported that Facebook did not engage with the SEC or its staff leading up to this announcement, and during his congressional testimony, David Marcus claimed that Libra wouldn't fall under the agency's jurisdiction because Libra would operate more like cash than a security, albeit some observers argue that it would operate as an ETF.

- a. What is your opinion of Libra?

**Answer:**

I appreciate your concern about cryptocurrencies that operate as securities. This is a concern that I face on a regular basis. Without weighing in on a particular company or product, I will note that the federal securities laws have anti-fraud and other remedial provisions that are principles-based and drafted in a broad and flexible way that contemplate substance over form. In other words, regardless of whether a novel product is labeled a cryptocurrency or a security, if it operates as a security, the SEC has jurisdiction over it and will not hesitate to ensure that investors are afforded the protections of our federal securities laws. Those violating our rules will be pursued and punished.

The Commission issued a Report of Investigation in July 2017 that applied longstanding securities law principles to demonstrate that a particular token constituted an investment contract and therefore was a security under the federal securities laws. As this report demonstrated, this analysis is very dependent on the facts of the situation at hand. The Commission has brought several enforcement actions against companies for issuing tokens without complying with their obligations under the securities laws, and the facts of each case are different.

In addition to enforcement actions, the SEC and its expert staff have worked hard the past few years to engage with the market through speeches, published guidance, and through the creation of the SEC's Strategic Hub for Innovation and Financial Technology ("FinHub"). The FinHub plays an important role in facilitating the SEC's active engagement with innovators, developers, and entrepreneurs. Through this engagement, I am confident that the expert staff at the SEC will continue to surveil this developing market and keep the Commission informed on developments.

- b. What steps do you think Congress should be taking?

**Answer:**

The federal securities laws and their principles-based application have served us well thus far when presented with novel and evolving issues that affect our securities markets, such as initial coin offerings and secondary trading of digital assets. However, if new issues arise that our current rules are not able to address, I will not hesitate to alert Congress and request additional authority to the extent I believe it is necessary to fulfill the SEC's mission.

- 2. Is Congress right to be concerned that the size of the private marketplace exceeds the public marketplace? How would you characterize the protections that current exist in the private placement marketplace for retail investors? Are they adequate?**

**Answer:**

Encouraging and facilitating the entrance of companies, especially smaller companies, to our capital markets is incredibly important to me, and I feel fortunate that I am at the SEC at a time when it is a priority for the Chairman as well. I think there is a combination of factors leading companies to stay private for longer. Traditionally, a lot of companies went public in order to raise money. However, there is presently plenty of money available in the private markets, and early stage investors appear to be more willing to hold onto their shares for longer than they used to be, such that there is less pressure on companies to go public earlier in their lifecycles to allow early investors to sell their shares. Other factors such as low interest rates and access to relatively cheap debt have also played a role.

Facilitating capital formation is part of the SEC's mission, and we are constantly reviewing our regulations to see whether particular rules are inhibiting capital formation and, if so, how they could be amended in a way that promotes capital formation while preserving or bolstering investor protection. The Commission has recently proposed or adopted several rulemakings with the goal of reducing issuer reporting burdens while ensuring that investors are still receiving material information about issuers. To the extent that regulatory burdens are discouraging private companies from entering the public markets, we are looking at ways we can reduce those burdens while preserving investor protections.

I believe it is important to stress that any offering of securities is either (1) registered with the SEC, (2) exempt from registration pursuant to our rules, or (3) illegal. In the private markets, we place restrictions on companies with respect to how they can raise capital through securities offerings as well as limits on who can invest in those offerings. And, of course, the anti-fraud provisions of our federal securities laws apply to both public and private offerings. Whether securities are sold in the public market pursuant to a registration statement, in the private market pursuant to an exemption, or illegally, the SEC has statutes and rules in place to help ensure that we can protect investors who have been defrauded.

- 3. How does the Commission reconcile their statements in the Concept Release about wanting to encourage more IPOs, but at the same time, expanding the private markets?**

**Answer:**

Over the years, and particularly since the Jumpstart Our Business Startups Act of 2012, several exemptions from registration have been introduced, expanded, or otherwise revised. As a result, the overall framework for exempt offerings has changed significantly. I believe our capital markets would benefit from a comprehensive review of the design and scope of our framework for offerings that are exempt from registration. I also believe that issuers and investors could benefit from a framework that is more consistent and addresses any gaps and complexities. Many

members of the public have commented in response to the SEC's Concept Release on Harmonization of Securities Offering Exemptions.<sup>10</sup> These comments have provided information on possible ways to simplify, harmonize, and improve the exempt offering framework to promote capital formation while preserving appropriate investor protections. I commend the SEC staff for undertaking the task of reviewing those comments and proposing a path forward in the proposed rule "Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets" that, if adopted, could hopefully streamline and tailor the exempt offering framework for businesses seeking to raise capital.<sup>11</sup>

I believe we must encourage and facilitate the entrance of companies to our capital markets, and I think the SEC's work to update our regulations relating to private offerings can help accomplish that. My goal in addressing harmonization of exempt offerings is not to expand the private markets, but to see if there is a way to encourage issuers to raise capital in our private markets earlier with the hope that that will result in them raising money in our public markets at an earlier growth stage. By studying the different profiles and needs of companies raising money in our private markets and how the current exemptions are utilized, my hope is that we can simplify and adjust our exempt offering framework in a way that makes it easier for private companies to transition to public companies. This, in turn, could allow Main Street investors to invest in public companies that have more growth potential.

4. **We continue to have a significant lack of information about the private marketplace. Even figures like \$3 trillion in private markets are, by the SEC's own admission, merely an estimate. Given this lack of information, and the corporate governance and valuation problems of privately-held companies, as recently highlighted by WeWork, it is concerning that the SEC is looking to push more retail investors into highly risky and speculative private placements; investments that do not appear to be in retail investors' "best interest."**
  - a. **Shouldn't the SEC be more focused on getting basic information about private markets before they consider such fundamental changes to those markets and putting Main Street investors at risk?**

**Answer:**

I take seriously the SEC's tripartite mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. Of course, I believe opportunities for investment should be expanded sensibly and in ways that still offer investors the information they need to make informed investment decisions. Our rules are never intended to push retail investors into any investment, and we do not evaluate the merits of any particular offering. Of course, in the context of any securities offering, if the issuer has violated any of our rules, the harmed investor or anyone else with information about wrongdoing in the market should notify the SEC's Enforcement Division.

<sup>10</sup> Concept Release on Harmonization of Securities Offering Exemptions, Rel. No. 33-10649 (June. 18, 2019), <https://www.sec.gov/rules/concept/2019/33-10649.pdf>.

<sup>11</sup> Proposing Release on Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, Rel. Nos. 33-10763; 34-88321 (Mar. 4, 2020), <https://www.sec.gov/rules/proposed/2020/33-10763.pdf>.

I appreciate the Commission's consistent efforts to gather information about private securities markets to inform policy-making. One example is the recent Concept Release on Harmonization of Securities Offering Exemptions, mentioned above. In that release, we provided the data about the private marketplace that we have available and requested data from commenters. Specifically, in our request for data, we stated that: "In particular, we seek quantitative data on fraudulent activity in the context of securities offerings conducted pursuant to a valid exemption from registration, as opposed to illegal securities offerings that fail to comply with the registration provisions of Section 5." The SEC also requested information about private markets in our recent rule proposal entitled Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, mentioned above. I look forward to receiving information in response to the proposal, and I will take all comments into account when evaluating staff recommendations at the adoption stage. I take the obligations under the Administrative Procedure Act seriously and believe that they improve and enhance every rule that we adopt.

Additionally, the Commission's advisory committees have been a helpful source of information. Recently, at the first meeting of the Asset Management Advisory Committee ("AMAC")<sup>12</sup>, the agenda included a fulsome presentation on various aspects of private securities markets, including the types of asset classes and their growth and volatility, as well as a discussion about which of these investments is or should be available to retail investors. I appreciate the feedback of the AMAC experts and their panelists, and I look forward to further discussion on these important topics.

- 5. There is broad and bipartisan support of this Committee for ensuring that the SEC has the authorities and resources it needs to be effective in protecting for seniors and elderly investors from registered and unregistered persons. What more can Congress do to help your office and the SEC in this regard?**
- a. What are the most urgent problems confronting senior investors that require attention?**

**Answer:**

I share your Committee's concerns regarding protecting older investors. On a personal level, I care deeply about this issue. I have heard countless stories from countless people about elder adults they know personally who were either victims or targets of fraud. When people tell me these stories, they always highlight how awful the crime was, or how bad it could have been.

Investor protection is fundamental to the SEC's mission and rests at the core of the decisions I make as a Commissioner. Falling victim to financial fraud or exploitation can, and often does, lead to adverse physical, emotional, and psychological effects well beyond the financial damage. We recognize this, and the SEC's efforts to combat fraud of older

<sup>12</sup> Spotlight on Asset Management Advisory Committee, <https://www.sec.gov/page/asset-management-advisory-committee>.

investors runs through every division and office of this agency. I would like to highlight a handful:

- Our Office of Investor Education and Advocacy regularly issues public alerts and bulletins to highlight problems and questions investors may encounter. Many of these materials specifically focus on elder investors.
- Our Office of Compliance Inspections and Examinations searches for signs of fraudulent schemes perpetrated through brokerage and advisory accounts. This includes how such registrants handle situations where diminished capacity may affect customer decision making.
- Our rulemaking efforts often have the goal of filling regulatory gaps, including through the efforts of the Divisions of Investment Management and Trading and Markets. Sometimes these efforts seek to protect investors by restricting what firms can do. At other times, however, the goal is to eliminate unnecessary barriers that might otherwise restrict the ability of firms to take practical steps to further investor protection.
- Our Division of Enforcement leads our efforts to punish those who mistakenly think they can get away with wrongdoing.
- Our Office of the Investor Advocate has published reports on elder financial exploitation and how the SEC works to protect senior investors.
- We have organized roundtables (with the securities industry and fellow regulators and law enforcement) and participated in other initiatives (like the Elder Justice Coordinating Council) to discuss the types of fraudulent and manipulative schemes currently targeting elder investors. The conversations have explored views from a broad range of regulators and industry experts on potential steps that regulators, broker-dealers, investment advisers, and others can take to identify and combat elder fraud.
- Lastly, many SEC employees volunteer and conduct outreach in elder communities and at events to educate seniors about potential frauds as well as to become a name and a face that investors can call. Our staff in our regional offices across the country are very active in these efforts (in particular, our Philadelphia, Los Angeles, and Miami Regional Offices).

Additionally, many of our efforts dovetail, or are done in conjunction with, those of FINRA, other SROs, state regulators, and federal agencies (including the U.S. Department of the Treasury and the U.S. Department of Justice). I appreciate the bipartisan support of this Committee, and Congress more broadly, as the SEC works hard to address elder investor fraud in our markets.

6. **Effective corporate governance is necessary for thriving U.S. capital markets. Many also believe that proxy advisory firms are an integral part of the proxy system that provide a valuable service to institutional investors like state and teacher retirement systems, pension funds, asset managers and mutual funds. Therefore, any changes to the proxy advisory industry warrant hard evidence as well as quantitative and qualitative analysis of the impact on the proxy advisory industry, the primary users of proxy reports (i.e. the investors). During the 2018 SEC Roundtable on the proxy process, you hosted a diverse panel, which included investors, issuers and Republican Senator Phil Gramm, former Chairman of the Senate Banking Committee, who when**

**asked by your staff, all agreed that no regulatory changes to proxy advisory firms are needed. Yet the Commission's latest guidance and forthcoming rulemaking contradicts this very conclusion. Why?**

**Answer:**

The proxy process is a fundamental aspect of our capital markets and one of the primary ways for shareholders to engage with management. In the past two decades, the proxy process has become one of increasing complexity and importance to investors, issuers, and investment advisers. During this time, investment advisers have assumed a much greater role in our marketplace and, consequently, a greater role in the area of shareholder-company engagement. These changing dynamics are part of the reason that the Chairman has prioritized efforts to improve the overall proxy process.

One area of particular focus for me has been the role of proxy advisory firms in the proxy process. The SEC has, for many years, engaged with the public through various forums on the topic of the proxy process and proxy advisory firms. For example, in 2010, the Commission issued a concept release that sought public comment about, among other things, the role and legal status of proxy advisory firms within the U.S. proxy system.<sup>13</sup> In 2013, the staff held a roundtable on the use of proxy advisory firm services by institutional investors and investment advisers.<sup>14</sup> In 2014, the staff of the Divisions of Investment Management and Corporation Finance issued a Staff Legal Bulletin to provide the staff's views about the availability and requirements of two exemptions to the federal proxy rules that are often relied upon by proxy advisory firms.<sup>15</sup> And, in November 2018, SEC staff held a proxy roundtable to discuss, among other things, the role of proxy advisory firms.

At the November 2018 Roundtable, panelists provided helpful insight into this and other topics, but feedback was not limited to those on stage. Much additional insight was also offered in the comment file related to the roundtable.<sup>16</sup> Many commenters expressed concerns about the methodologies used by proxy advisory firms, as well as about their conflicts of interest, lack of transparency, and propensity to make errors in reports to clients. Similar concerns had been raised previously in response to the Commission's 2010 Concept Release and earlier roundtables.

The Commission's Interpretation and Guidance Regarding Applicability of Certain Federal Proxy Rules to Proxy Voting Advice (the "Interpretation"), issued in August 2019, states the Commission's position that, as a general matter, the furnishing of proxy voting advice

<sup>13</sup> Concept Release on the U.S. Proxy System, Release No. 34-62495 (July 14, 2010) [75 FR 42982 (July 22, 2010)] ("2010 Concept Release"). The comment letters received in response to the Concept Release are available at <https://www.sec.gov/comments/s7-14-10/s71410.shtml>.

<sup>14</sup> See SEC Announces Agenda, Panelists for Roundtable on Proxy Advisory Services, available at <https://www.sec.gov/news/press-release/2013-253>. The letters received in response to the announcement are available at <https://www.sec.gov/comments/4-670/4-670.shtml>.

<sup>15</sup> SEC Staff Legal Bulletin No. 20, Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms (June 30, 2014).

<sup>16</sup> See Comments on Statement Announcing SEC Staff Roundtable on the Proxy Process; File No. 4-725, available at <https://www.sec.gov/comments/4-725/4-725.htm>.

constitutes a “solicitation” within the meaning of Exchange Act Rule 14a-1.<sup>17</sup> This position is not new, and the Interpretation itself contains a detailed history of the Commission’s prior statements on this matter.

The Commission’s recent Proposed Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice (the “Proposal on Proxy Voting Advice”) make certain changes to the conditions for exemptions from the federal proxy rules, on which proxy advisory firms most commonly rely.<sup>18</sup> Those changes include disclosure of conflicts of interest to clients and a proposed mechanism for public companies to provide feedback to proxy advisory firms on the recommendations in order to identify any methodological weaknesses or factual errors before investment advisers rely on the recommendation. The Proposal on Proxy Voting Advice also contains an economic analysis, which analyzes the costs and benefits of the proposal, and requests any additional data that would be helpful to the staff in formulating a final recommendation.

- 7. In the SEC’s latest guidance regarding investment advisers and proxy advisory firms, you appear to have disregarded the concerns and conclusions on the issue of proxy advisory firm regulation put forth by the Office of the Investor Advocate, most recently in statement by Rick Fleming in April of this year. Why did you reject the views of the Office of the Investor Advocate?**

**Answer:**

Matters related to the proxy process are of great importance to me, and I recognize they are important to many others as well. In my statement at the August 21, 2019 Open Meeting, supporting adoption of the Commission Guidance and Interpretation Regarding Proxy Voting and Proxy Voting Advice, I expressed my sincere belief that the guidance and interpretation provided by the Commission aim to protect the retail investors who have their life savings invested in our stock markets. It is these individual investors, rather than the asset managers who invest on their behalf, who will benefit from or bear the ultimate burden of an asset manager’s voting decision. I believe it is the Commission’s job, as a regulator, to help ensure that asset managers—many of whom are regulated entities that we oversee—vote proxies in a manner consistent with their fiduciary obligations and that the proxy voting advice, upon which they rely, is complete and based on accurate information.

- 8. The SEC’s latest guidance regarding investment and proxy advisory firms directly mirrors corporate talking points, including those perpetuated by groups like the “Main Street Investor Coalition,” which you cite in your own statement. One of the main allegations made by these groups is that investment advisors engaged in so-called “robo voting” (i.e. blindly follow proxy advisory firms’ advice) - what evidence do you have to support this assertion?**

<sup>17</sup> See the Interpretation, at pages 5–6.

<sup>18</sup> Proposed Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Rel. No. 34-87457 (Nov. 5, 2019) [84 FR 66518 (Dec. 4, 2019)].

**Answer:**

Proxy advisory firms themselves have acknowledged that their electronic voting platforms offer their clients the service of pre-populating the applicable proxy advisory firm's voting recommendations in the clients' electronic voting instructions on that platform. Clients utilizing such services may choose to review the pre-populated ballots before they are submitted or to have them submitted automatically, without further client review ("automatic submission" or "robo-voting").<sup>19</sup> In the comment file for the 2018 Roundtable, several commenters expressed concern about the role that proxy advisory firms play in the proxy voting process, largely due to these pre-population and automatic submission functions, citing a variety of evidence and academic research.<sup>20</sup> The Proposal on Proxy Voting Advice requests comment on whether the Commission should make changes to limit the use of these functions, and provides examples of such possible limitations.

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<sup>19</sup> See, e.g., Letter from Katherine Rabin, Chief Executive Officer, Glass, Lewis & Co., LLC (Nov. 14, 2018) ("Glass Lewis Letter"), at 2, 4 (describing how ballots are populated and submitted).

<sup>20</sup> See, e.g., letter from Business Roundtable (Jun. 3, 2018); letter from Nadya Malenko, Boston College, and Yao Shen, Baruch College (Oct. 12, 2018); letter from American Council for Capital Formation (Nov. 14, 2018).

**Commissioner Peirce**

1. Facebook announced plans to develop a new cryptocurrency, Libra, and a wallet for it to be stored on, Calibra, in June. It has been reported understand that Facebook did not engage with the SEC or its staff leading up to this announcement, and during his congressional testimony, David Marcus claimed that Libra wouldn't fall under the agency's jurisdiction because Libra would operate more like cash than a security, albeit some observers argue that it would operate as an ETF.
  - a. What is your opinion of Libra?

**Answer:**

My knowledge of Libra is limited to information in the public domain, which is not sufficient for me to make an assessment of which laws would or should govern Libra.

- b. What steps do you think Congress should be taking?

**Answer:**

I commend the efforts Congress is undertaking to learn about digital assets, including Libra. The potential for digital assets and blockchain technology to transform our society suggests that Congress and financial regulators ought to be working to develop an appropriate regulatory framework. When I speak with entrepreneurs in this space, a constant refrain is that they would like to work in the United States, but regulatory uncertainty has driven them offshore. An appropriate regulatory framework for digital assets could allow innovation to occur here, draw talent to the United States, and allow Americans to reap the benefits of a technology that holds significant promise to bring people into the market economy, who have thus far been excluded from it. Congress has an important role to play in ensuring that regulators—including the Securities and Exchange Commission, the Commodity Futures Trading Commission, the banking regulators, and FinCEN—work together to build an effective legal framework.

2. Is Congress right to be concerned that the size of the private marketplace exceeds the public marketplace? How would you characterize the protections that current exist in the private placement marketplace for retail investors? Are they adequate?

**Answer:**

Vibrant private and public capital markets are key building blocks of our economy. The relative attractiveness of private markets versus public markets can serve as a warning to us that we need to recalibrate the regulations associated with the public markets. When the size of the private market grows and the size of the public market shrinks, we should be asking ourselves what we can do to make raising capital in our public markets less burdensome for issuers, while also ensuring that investors in the public markets continue to have access to the information they need to make sound investment decisions.

As a believer in the right of all investors to spend their hard-earned money as they see fit, I find the limitations placed on investors' ability to access the private markets troubling. Our regulations should respect the liberty of retail investors to pursue investment opportunities that are appropriate for their investment portfolios, but the current restrictions instead prohibit them from investing. An important component of investor protection is the preservation of an investor's right to think for herself. We have gotten this piece of investor protection wrong in our rules by inappropriately limiting access to the private markets.

**3. How does the Commission reconcile their statements in the Concept Release about wanting to encourage more IPOs, but at the same time, expanding the private markets?**

**Answer:**

On the one hand, the public markets are the primary way that retail investors take part in the growth of the economy. Even if we were to allow retail investors greater access to the private markets, most of them likely would continue to invest primarily in the public markets. For many issuers, transitioning to the public markets is a key milestone. It is therefore important that we analyze why many companies are waiting so long to go public and that we establish a regulatory framework that encourages companies to go public earlier and to remain public. Retail investors should not be shut out of companies' growth, much of which now occurs in the private markets.

On the other hand, the private markets are an important venue for capital formation, particularly for new companies. However, the private markets rely on a complex panoply of exemptions and rules, each of which carries with it unique requirements, some of which do little to protect investors. By modernizing and streamlining the rules applicable to the private markets, we can make it easier for companies to raise capital in the private markets. Lowering the cost and complexity of raising capital in the private markets will make it easier for entrepreneurs to start the ventures that form the backbone of our economy and our communities. Today, private capital is wedded to the coasts and only rarely makes its way inland to fund the renaissance of cities like my hometown of Cleveland, Ohio. I want to change that, and well-functioning private capital markets are an essential part of the solution.

- 4. We continue to have a significant lack of information about the private marketplace. Even figures like \$3 trillion in private markets are, by the SEC's own admission, merely an estimate. Given this lack of information, and the corporate governance and valuation problems of privately-held companies, as recently highlighted by WeWork, it is concerning that the SEC is looking to push more retail investors into highly risky and speculative private placements; investments that do not appear to be in retail investors' "best interest."**
- a. Shouldn't the SEC be more focused on getting basic information about private markets before they consider such fundamental changes to those markets and putting Main Street investors at risk?**

**Answer:**

The objectives of democratizing access to our private markets and getting better data about private markets—both important—are not mutually exclusive. We know enough about private markets to see the potential benefits of giving retail investors an opportunity to share in the growth that is available now almost exclusively to wealthy investors. Retail investors, many of whom work with financial professionals, are capable of deciding whether and how to invest their hard-earned money. As we think about potential changes in this area, however, we are thinking holistically about investor protection. Reforms, for example, that enable retail investors to access private markets through professionally managed funds could help retail investors gain diversified exposure to the private markets while maintaining appropriate investor protections. Additionally, strong enforcement of our antifraud rules should accompany any opening up of the private markets to greater retail participation.

5. **Earlier this year, you gave a speech expressing concerns over the transparency of certain kinds of staff guidance emanating from the agency. While you have criticized some of the SEC's enforcement initiatives as a general matter, you apparently have yet to issue a public dissent to explain your reason for voting no in any enforcement case. If you feel so strongly, why haven't you done so? Doesn't the public deserve to know why you felt the need to vote no in an enforcement action?**

**Answer:**

I appreciate the suggestion to issue more public dissents on enforcement actions. I generally have not commented on individual enforcement cases. Sometimes, I choose to remain silent out of deference to my colleagues' decision to litigate a case. I have made several public speeches, however, that provide a general overview of my enforcement philosophy and the considerations that affect my voting decisions.<sup>21</sup> These statements summarize my concerns with certain types of cases that regularly appear before us and on which I often dissent (*e.g.*, cases involving penalties on corporations that harm wronged shareholders, penny stock bars against individuals who have not engaged in penny stock wrongdoing, or matters that could have been handled through our compliance function). As you suggest, however, individual dissents may be helpful, and I will consider this option when appropriate.

6. **Can you describe how users can remain anonymous when using cryptocurrency, and the challenges anonymity brings to tracking illicit activity and illegal purchases?**

**Answer:**

Cryptocurrencies differ from one other in the level of anonymity they provide. Some cryptocurrencies are far easier to trace than cash. Anti-money laundering and know-your-customer requirements apply to cryptocurrency transactions, just as they do to other kinds of transactions, and regulators are focused on ensuring adherence to these requirements.

<sup>21</sup> See, *e.g.*, <https://www.sec.gov/news/speech/peirce-broken-windows-51st-annual-institute-securities-regulation>; <https://www.sec.gov/news/speech/speech-peirce-050819>; <https://www.sec.gov/news/speech/peirce-speech-lies-statistics-102618>; <https://www.sec.gov/news/speech/peirce-why-behind-no-051118>.

Congresswoman Joyce Beatty (OH-03)  
Committee on Financial Services  
"Oversight of the Securities and Exchange Commission: Wall Street's Cop on the Beat"  
September 24, 2019 at 10:00am – Rayburn 2128

Questions for the Record

Question #1

This question is for Chairman Clayton.

The Sarbanes-Oxley Act of 2002, P.L. 107-204, grants the Securities and Exchange Commission ("Commission") the authority and responsibility of appointing members of the board of the Public Company Oversight Accounting Board ("PCAOB"). Last week, my office received a troubling complaint regarding a divergence in the reappointment process from past years with regards to the expiring term of Board member Kathleen Hamm along with a link to an article entitled, "Regulator seeks to keep job at PCAOB, but SEC looks for new candidates." The complaint and article allege that current Board member Kathleen Hamm is effectively being prevented from serving a second term.

As Chairwoman of the Subcommittee on Diversity and Inclusion, I am extremely alarmed to hear reports that the lone female Board member of the PCAOB is facing a different reappointment process from past Board members. I have a series of questions to better understand the reappointment process and the situation with the expiring term of Kathleen Hamm.

1. Can you explain the current process for appointing and reappointing Board members to the PCAOB?
2. How has this process changed over the last ten years? Besides the decision by the Commission to release en masse all five Board members in December 2017, has there ever been any instances where the Commission declined to reappoint a Board member eligible for a second term? If so, please explain.
3. Besides the decision by the Commission to release en masse all five Board members in December 2017, has there ever been any instances where the Commission declined to reappoint a Board member eligible for a second term? If so, please explain.
4. Board member Duane DesParte was recently reappointed to a second term.
  - a. What process was followed concerning to his reappointment?
  - b. Were there any differences in his reappointment process compared to Kathleen Hamm's expiring term? If so, how and why did the process change?
  - c. Was there a public solicitation for his board seat? If not, why. Specifically, was his expiring Board seat publicly posted for applicants and did he have to reapply for it?

Answer:

**Congresswoman Joyce Beatty (OH-03)**  
**Committee on Financial Services**  
**“Oversight of the Securities and Exchange Commission: Wall Street’s Cop on the Beat”**  
**September 24, 2019 at 10:00am – Rayburn 2128**

The PCAOB was created by the Sarbanes-Oxley Act of 2002 in the wake of corporate and accounting scandals that cost investors billions of dollars. The PCAOB’s mission is focused on a specific aspect of our capital markets ecosystem—preserving and improving the quality and reliability of public company audits and the audits of SEC-registered brokers and dealers for the protection of investors. Audited financial statements are at the heart of the SEC’s disclosure-based regulatory regime; a company’s financial statements provide investors with a wealth of material information, including quantitative information that informs more qualitative disclosures. The requirement of an independent audit of those financial statements works to improve their quality and provides investors with additional comfort that those statements were prepared properly and are accurate. Oversight of the PCAOB is an important Commission function.<sup>1</sup>

The Commission’s oversight of the PCAOB includes the selection and removal of the Board members. The Commission’s oversight of the Board also includes, among other items, the authority to: (1) approve the budget and manage the operations of the Board and the staff of the Board; (2) review disciplinary actions by the Board and, as appropriate, modify or cancel the sanction; (3) amend the rules of the Board; (4) rescind Board authority; (5) censure the Board or remove a Board member; and (6) require the Board to perform such other duties or responsibilities as the Commission determines are necessary or appropriate to promote high professional standards and improve the quality of audit services or otherwise further the PCAOB’s mission.

Under the Sarbanes-Oxley Act of 2002, the Commission is responsible for appointing members, including the Chair, of the Public Company Accounting Oversight Board (PCAOB). Given the PCAOB’s important mission, I approach the responsibility of appointing PCAOB members with care and respect, and I am committed to ensuring a robust, deliberate and fair process for Commission consideration of PCAOB members. As described on the SEC’s website,<sup>2</sup> the procedures for these appointments include the following:

- The Commission Chairman leads a public search to identify a pool of potential candidates who meet the statutory criteria set forth in the Sarbanes-Oxley Act.<sup>3</sup> Nominations and input are solicited from each Commissioner and may also be solicited from other sources. The Chairman also consults with the Secretary of the Treasury and the Chairman of the Federal Reserve.
- From this initial pool, generally up to four potential candidates for each vacancy are contacted to determine their interest and willingness to serve. Each potential candidate who is interested in serving is asked to provide curricula vitae and to complete a background questionnaire and release.

<sup>1</sup> Commissioner Allison Herren Lee has recused herself from PCAOB matters because her husband is a Board member.

<sup>2</sup> See “PCAOB Appointment Process,” at <https://www.sec.gov/financial-reporting-structure>.

<sup>3</sup> In practice, the process for soliciting nominations and input from Commissioners is conducted by the Office of the Chief Accountant under the Chairman’s supervision.

**Congresswoman Joyce Beatty (OH-03)**  
**Committee on Financial Services**

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- After consultation with each Commissioner, the Chairman may decide to eliminate any candidate from further consideration. In addition, the Chairman may, again in consultation with each Commissioner, replace a candidate with a new candidate from the pool.
- The Chairman initiates an in-depth background check for each remaining candidate. In the case of an individual who is either an incumbent member of the PCAOB or a presidential appointee, the Commissioners may by unanimous agreement waive the requirement for a background check.
- Upon completion of the background check, the Chairman selects up to three candidates for each vacancy to be interviewed by the Commission. Each Commissioner receives a copy of all background and other relevant documentation that has been collected by the staff. After each Commissioner has had the opportunity to interview every candidate, each Commissioner ranks the candidates and/or informs the Chairman if the Commissioner will not support one or more of the candidates for appointment.
- At the completion of the interview and evaluation process, the Chairman again consults with the Secretary of the Treasury and the Chairman of the Federal Reserve. Then, after a reasonable opportunity for consideration, the Chairman seeks a vote of the Commission to approve appointment of a candidate.
- Alternatively, if the Chairman, in consultation with each Commissioner, determines that other candidates should be considered, the Chairman may select additional candidates from the pool or reopen the solicitation period.

To my knowledge, the process has not changed since it was last updated in 2010.

In recent years, there have been a number of operational and other challenges at the PCAOB. Several months prior to my arrival, in early 2017, the Commission commenced an inquiry into the Board’s failure to notify the Commission promptly about misconduct by a Board member that led to that member’s resignation. This inquiry, which was directed by the SEC’s Office of the Chief Accountant (OCA) and the Office of the General Counsel (OGC), resulted in a recommendation by members of the staff that the Commission, among other things, appoint new members to the Board and replace certain senior officers at the PCAOB. At that time, there was a vacant Board seat and several of the Board members’ terms had expired. The Commission—Commissioners Stein, Piwowar and I—accepted the staff’s recommendation and undertook a process to appoint a new Board, including a new Chair.

In December 2017, the SEC announced the appointment of a new PCAOB Chairman and four new PCAOB Board Members. The five appointees have staggered terms that expired or will expire between 2018 and 2022. When Mr. DesParte joined the Board on April 9, 2018, he became the last appointee of the five to take a seat, and he took the seat with the shortest remaining term, which expired on October 24, 2018. As a result of Mr. DesParte’s brief first term of six months (April 2018 to October 2018), there was no public solicitation in connection with his board seat, as was the expectation at the time of appointing the new Board. Mr. DesParte’s reappointment process included Commission interviews, consultation with the Chairman of the Federal Reserve and Secretary of the Treasury and a Commission vote.

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Since the PCAOB’s formation in 2002, only 12 Board members, including Kathleen Hamm, preceded the current Board members. Two Board members, excluding Ms. Hamm, were not appointed to a second term, both of whom resigned from the Board before completing their terms. In October 2019, after completion of the SEC’s formal process, which included a public statement soliciting interest and interviews of certain candidates, including Ms. Hamm, the Commission voted to appoint Rebekah Goshorn Jurata to the PCAOB Board. Ms. Jurata has broad financial services policy experience both domestically and internationally, from her professional experience serving in senior roles at the National Economic Council, Treasury Department, the House Financial Services Committee and the SEC, where she began her professional career and later served as counsel to former SEC Commissioner. I believe her understanding of our financial markets and international experience will serve the PCAOB well.

**Question #2**

The following question is for Commissioner Jackson.

On June 11, 2018, you gave a speech to the Center for American Progress entitled, “Stock Buybacks and Corporate Cashouts” where you stated that there was “clear evidence that a substantial number of corporate executives today use buybacks as a chance to cash out the shares of the company they received as executive pay.” You also stated that if corporate executives believed that buybacks created long-term shareholder value as they say, then they wouldn’t and shouldn’t be selling their own shares into the buyback.

In a Wall Street Journal article from July of 2018, entitled, “The Real Problem With Stock Buybacks,” Harvard Professors Jesse Fried and Charles Yang argue that companies should have to disclose buybacks the same way executives are required to disclose the buying and selling of their own company’s stock – within 2 days. They argue this will help shed light and increase transparency on some of the reasons a company and its executives decide to engage in buying back stock for the company.

What are your thoughts on this proposal?

**Question #3**

The following question is for Commissioner Jackson and Commissioner Lee.

Last month, the Commission adopted two guidance documents relating to proxy voting advice by a vote of 3-2. At the SEC Roundtable on the Proxy Process, the Ohio Public Employees Retirement System (OPERS) Corporate Officer testified that OPERS did not believe additional regulation of proxy advisory firms is necessary and is concerned that the

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**SEC will adopt unwarranted regulation that will raise the costs and increase time restraints on them. OPERS is the largest public retirement system in Ohio, with more than 1 million members. If costs on them go up, that means that costs on more than 1 million Ohioans, plus costs on other pension plans such as Firefighter and Teacher pension plans also go up.**

**Why did you vote against adoption of this proposal?**

**Answer:**

I voted against the guidance the Commission issued in August of 2019 because I was, and remain, concerned about the potential impact it will have on the cost of much needed proxy voting advice much of which will likely be borne by investors, including public retirement funds and, by extension, the individuals whose retirement savings are in those funds. In addition, increased costs to proxy advisory firms may increase barriers to entry in what is already a highly concentrated market dominated by two firms. The guidance may also compromise the reliability and independence of the proxy advice investors pay for by increasing involvement into that advice by issuers with a clear stake in the outcome of the vote, and thus a conflict of interest.

**Question #4**

**This question is for Chairman Clayton.**

**Pursuant to Section 342 of the Dodd-Frank Act, the Commission is required to assess the diversity policies and practices of its regulated entities. The Commission’s 2019 Office of Minority and Women Inclusion Annual Report to Congress stated that out of the 1,367 investment advisers, broker-dealers, municipal advisors and self-regulatory organizations asked to submit a “Diversity Assessment Report for Entities Regulated by the SEC,” the Commission only received 38 individual responses.**

**Another agency subject to Section 342 of Dodd-Frank found that they received more responses from the previous year when the head of the agency signed the assessment request that went out to its regulated entities. With a response rate so low, what are you doing to ensure more of the Commission’s regulated entities submit a diversity assessment next year? Did you sign last year’s the assessment request that went out to regulated entities? If not, would you consider doing so for next year’s request?**

**Answer:**

The SEC is firmly committed to advancing diversity, inclusion and opportunity within agency leadership and the workforce. We promote these just and value-enhancing principles on many fronts both within the SEC and through our outreach to market participants, including our

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outreach to Main Street investors and historically underrepresented communities. I believe promoting diversity, inclusion and opportunity in our workplaces and more generally is not only a shared societal obligation, it also is value-enhancing. The SEC’s Office of Minority and Women Inclusion (OMWI) Director Pam Gibbs has been instrumental in our efforts to promote diversity, inclusion and opportunity. Through OMWI’s leadership, the SEC recently finalized our first Diversity and Inclusion Strategic Plan, which will help guide how the agency will continue to promote diversity, inclusion and opportunity within our workforce, as well as with respect to supplier relationships and the entities we regulate.

Additionally, Robert Marchman recently joined the Commission to serve as our first Senior Policy Advisor on Diversity and Inclusion. Mr. Marchman is a distinguished professional and has a demonstrated history of adding value to organizations on many levels, including through his leadership in diversity and inclusion. In this new role, Mr. Marchman will be responsible for developing and implementing strategies to promote diversity and inclusion, both within the SEC’s divisions, offices and advisory committees and through external engagement with agency partners and market participants.<sup>4</sup> It is incumbent upon the Commission to attract and hear from those with experience and expertise from outside the SEC, and this new role will be key in facilitating those conversations, attracting talent to our agency and developing other strategies to add tangible value.

I believe our increased focus on diversity in the financial services industry and the related value-enhancing proposition it entails is a positive step forward. I also recognize that our efforts in this area must also be lasting and tangible, and there is more we can do. In 2018, the SEC launched its first-ever Diversity Assessment Report and communicated directly with approximately 1,300 of the largest SEC-registered firms to encourage responses. While I am told that the 38 firms that responded represent almost half of the employees in the securities and investment industry, the results in terms of total firm participation are disappointing. I share your concerns about the relatively low number of responses received during year one of the Diversity Assessment Report and believe this is an area where we can do more. Ms. Gibbs and I have discussed this issue at length and remain in close communication about increasing responsiveness.

In January 2020, the SEC began inviting regulated entities to once again submit Diversity Assessment Reports and will send additional requests later this year. SEC staff, led by Ms. Gibbs and Mr. Marchman, is taking additional steps to incentivize participation and get more entities to share information about efforts to enhance diversity and inclusion in their organizations. These steps include encouraging regulated entities to conduct self-assessments of their diversity policies and practices and share their self-assessments at educational events and conferences hosted by industry trade associations and professional organizations. For example,

<sup>4</sup> See Press Release 2019-273, SEC Announces Robert A. Marchman as Senior Policy Advisor on Diversity and Inclusion (Dec. 19, 2019), available at <https://www.sec.gov/news/press-release/2019-273>.

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the SIFMA Compliance and Legal Conference and Practicing Law Institute SEC Speaks Conference has provided opportunities for the SEC to engage regulated entities in discussions about the benefits of diversity and inclusion. The SEC has used these annual forums to promote the Joint Standards and raise awareness about the Diversity Assessment Report.

Additionally, on October 24, 2019, the Offices of Minority and Women Inclusion of the SEC and other financial regulatory agencies held their second annual Financial Regulatory Agencies’ Diversity and Inclusion Summit at the Chicago Reserve Bank. In addition to providing a forum for business leaders and diversity professionals to discuss best practices for advancing diversity and inclusion, the Summit gave the OMWI Directors an opportunity to talk about the responses to their requests for diversity self-assessments and steps that might be taken to increase the number of responses. In response to comments by some that in some instances requests for diversity self-assessments were not sent to the correct person at their institutions, OMWI sent emails to the Chief Compliance Officers (CCOs) of SEC-regulated entities requesting that they provide the appropriate point of contact in their organizations to receive future communications about the Diversity Assessment Report. Sending the request to the appropriate person at the outset should help increase the number of responses.

Additionally, some have expressed the view that some entities would not submit diversity self-assessments if they could not respond “yes” to most of the questions asked. The SEC has highlighted that the Joint Standards are intended to be applied in a manner appropriate to the regulated entity’s unique characteristics, such as workforce size, governance structure, total assets, and geographic location, and that some standards may not be applicable to every regulated entity. By emphasizing that not every standard will apply, the SEC hopes entities that may have been deterred from sharing diversity self-assessments because they could not respond “yes” to most of the questions asked in the Diversity Assessment Report will choose to respond. The SEC is hosting a series of webinars for regulated entities to encourage them to conduct diversity self-assessments and address their questions about the Diversity Assessment Report. Staff will continue to explore ways to incentivize regulated entities to share diversity self-assessment information with the Commission, and I will encourage SEC-regulated entities to complete the Diversity Assessment Report and share information about their efforts to promote diversity and inclusion.

**Rep. Ted Budd**  
**Questions for the Record**  
**House Committee on Financial Services**  
**Hearing: Oversight of the Securities and Exchange Commission:**  
**Wall Street's Cop on the Beat**  
**September 24, 2019**

- 1. Proxy advisory firms have been shown to make significant errors when issuing proxy vote recommendations, and the firms have substantial conflicts of interest baked into their business model. I appreciate that the recent guidance issued by the SEC makes clear that the proxy solicitation rules' anti-fraud provisions apply to these firms. What impact will this clarification have on proxy advisory firms, and how can the SEC build on the guidance with rulemaking to modernize the proxy solicitation rules?**

**Answer:**

The proxy process is a fundamental aspect of our capital markets and one of the primary ways for shareholders to engage with management. Proxy voting advice businesses play a significant role in the voting process today, providing an array of voting services that help clients manage their proxy voting needs and make informed voting decisions. Serving thousands of clients who exercise voting authority over a sizeable number of shares that are voted annually, proxy voting advice businesses are uniquely situated to influence investors' voting decisions. These market developments require our attention. Modernization of regulation, including to adjust for market developments and advances in technology, is critical. It is important that investors using proxy voting advice businesses receive accurate, transparent and complete information on which to base their voting decisions.

The Commission's guidance and interpretation issued in August 2019 was an important step in the Commission's ongoing efforts to strengthen the proxy voting process. Building on these efforts, in November 2019, the Commission proposed amendments to the rules governing proxy solicitations to improve the accuracy and transparency of disclosures that proxy voting advice businesses provide to their clients about material conflicts of interest. To help ensure that sufficient information about these conflicts of interest is provided consistently across proxy voting advice businesses, the proposed amendments would condition certain exemptions from the proxy solicitation rules to specify that the exemptions would be available to proxy voting advice businesses only to the extent that they include required conflicts of interest disclosures in their proxy voting advice at the time the advice is provided to clients. The proposal also included guidance on, including examples of, when the failure to disclose certain information in the proxy voting advice, including information with respect to conflicts of interest, could, depending on the particular facts and circumstances, be considered misleading within the meaning of Rule 14a-9. The proposed amendments also would provide an opportunity for a brief period of review and feedback through which registrants will be able to identify any factual errors or methodological weaknesses in the proxy voting advice and proxy voting advice businesses would have an opportunity to amend and supplement their reports to the extent they believed necessary, if at all.

In response to the proposal as well as in connection with the roundtable the Commission held in 2018 on improving the proxy process that brought together investors, issuers and other market participants, we have received significant public comment and helpful suggestions to improve our proxy voting system. In addition, I understand that commenters have identified areas of improvement for the proxy system for funds and their shareholders. The staff will consider comments received in any recommendations it may make to the Commission with respect to final rules. While there are a wide range of viewpoints on these topics, one thing is clear—there is significant interest in modernizing and improving the proxy process.

2. **The SEC has made very clear that proxy voting is important, and that proxy voting decisions made by asset managers are done so within the context of their fiduciary duty to Main Street investors. Chairman Clayton you have specifically stated that “there is not—and there never has been—a carve-out from the investment adviser fiduciary duty for proxy voting responsibilities that an investment adviser has assumed.” How does the recent SEC guidance on asset manager oversight of proxy advisory firms help them fulfill that fiduciary duty?**

**Answer:**

The Commission’s August 2019 represented an important first step in strengthening the integrity of the proxy voting process. Specifically, the Commission issued guidance to assist investment advisers in establishing and fulfilling their proxy voting responsibilities. Voting is a key component of shareholder engagement and investing generally. The guidance emphasizes that investment advisers are fiduciaries that owe each of their clients duties of care and loyalty with respect to services undertaken on a client’s behalf, including voting. To the extent an investment adviser assumes voting responsibilities, it must discharge those important responsibilities in accordance with its fiduciary duty. In other words, there is not—and there never has been—a carve-out from the investment adviser fiduciary duty for proxy voting responsibilities that an investment adviser has assumed.

The guidance provides examples to help facilitate investment advisers’ compliance with their proxy voting responsibilities, including if they retain a proxy advisory firm to provide research or voting recommendations as an input to the adviser’s voting decisions. For example, the guidance discusses steps an investment adviser could take to demonstrate that it is making voting determinations in a client’s best interest and in accordance with the investment adviser’s proxy voting policies and procedures. The guidance also discusses: (1) how an adviser and its client may agree upon the scope of the adviser’s voting authority; (2) steps an adviser could take to demonstrate it is making voting determinations in a client’s best interest; (3) considerations that an adviser should take into account when retaining a proxy advisory firm; (4) steps an adviser could consider when it becomes aware of potential factual errors that could materially affect a voting determination; (5) how an adviser could evaluate the services of a proxy advisory firm; and (6) whether an adviser with voting authority is required to vote every proxy for its client.

3. **Exchange traded-funds or ETFs are some of the most popular tools for investors to reduce risk, diversify their portfolios and invest in the stock market. To help those**

**investors and create more market competition, is the SEC exploring the possibility of allowing existing open-end mutual funds to be converted into exchange-traded funds? Does the SEC have any plans to help facilitate such conversions?**

**Answer:**

Mutual funds can convert into ETFs, as long they comply with applicable requirements. Our new ETF rule, in fact, specifically addresses conversions and other reorganizations involving ETFs. We understand that sponsors of mutual funds have not converted their mutual funds into ETFs on account of practical, rather than regulatory, issues. These include, for example, differences in how investors typically hold shares of these types of funds. I understand that the industry is working to find solutions to these issues, and industry participants have been engaged in discussions with us regarding this topic. SEC staff will continue to be available for discussions with mutual fund sponsors interested in conversion of their funds into ETFs.

**4. In the event of an economic downturn, what tools does the SEC have at its disposal to calm markets and ensure adequate liquidity levels for investors, and is the SEC looking into any plans to improve upon these tools?**

In times of economic stress, a key focus for the Commission is orderly and fair market function, which is essential to investor protection. Staff across the SEC's divisions and offices continually monitor our capital markets with respect to function, prices and price movements, capital flows and credit availability. Given the recent economic downturn and volatility associated with COVID-19, I will address your question given the SEC's most recent experiences.

Following the 2008 financial crisis, the SEC has taken a series of steps to address periods of extraordinary volatility and reduce market disruptions. These reforms—including the implementation of market-wide circuit breakers—have been recently tested during the COVID-19 pandemic. I am pleased that despite these extraordinary volumes and volatility, our market infrastructure has functioned largely as designed, and importantly, as market participants would expect. In other words, we can report that during this time of unprecedented stress, we have observed no systemically adverse operational issues with respect to our key infrastructure.

During this time, SEC staff have engaged closely with key market participants—including exchanges, clearing agencies, liquidity providers, public accounting firms and credit rating agencies—regarding market trends and developments, operational challenges and business continuity planning efforts. The SEC has used its regulatory tools available to help facilitate the continuing orderly and fair function of our markets by providing guidance and targeted regulatory relief and assistance as appropriate.

We also work closely with our domestic and international regulatory counterparts. The SEC has benefited from this engagement, including discussions concerning the innumerable linkages, interconnections and continually evolving dynamics between global banking, housing finance, commodities and other markets and our capital markets with an eye toward identifying

areas of stress and vulnerability and potential mitigating actions. The rapid fiscal, monetary and financial regulatory response to market and economic effects of COVID-19 has been both remarkable and appropriate, and in my opinion, these efforts to preserve the flows of credit and capital in our economy have substantially mitigated the economic consequences of COVID-19.

Finally, the SEC formalized an internal, cross-divisional COVID-19 Market Monitoring Group would function as a focal point for managing and coordinating our efforts to both monitor and respond to the effects of COVID-19 on markets, issuers and investors and assist other regulators and public sector officials.<sup>1</sup> In addition to the ongoing broad market-oriented work, we have also initiated work initiatives to: (1) identify, analyze and clarify interconnections across key segments of our financial markets with increased specificity; and (2) analyze the potential risks and downstream effects of investment strategies and mandates that include or are subject to mechanistic rules, guidelines or restrictions on holdings of assets, such as references to credit ratings and downgrades. This work supports and complements similar efforts being undertaken by our domestic and international regulatory partners.

5. **What is the SEC's position on moving to tri-annual reporting (i.e., reporting every four months)?**
6. **Last year the SEC requested public comment on the question of moving from quarterly to semi-annual reporting frequency without mentioning any other potential frequencies. Will you commit to issuing an official request for comment through the federal register on the specific question of moving from quarterly to tri-annual reporting?**

**Answer (Questions 5&6):**

In July 2019, SEC staff hosted a roundtable entitled Short-Term / Long-Term Management of Public Companies, Our Periodic Reporting System and Regulatory Requirements. At the roundtable, we received encouragement from panelists with a wide variety of viewpoints to consider permitting certain classes of reporting companies, such as emerging growth companies or smaller reporting companies, to have flexibility as to the frequency of reporting.

Further, among the questions raised in the December 2018 Request for Comment on Earnings Releases and Quarterly Reports, the Commission sought input on moving to a semi-annual reporting model for all or certain classes of reporting companies, in addition to asking whether any other frequency of reporting model would be more appropriate. As such, I do not believe a separate request for comment on the question of moving from quarterly to tri-annual reporting is necessary.

While we have received some input from the public encouraging a tri-annual reporting system, most commenters addressing the subject focused on a semi-annual reporting model. Revisiting the frequency of disclosure of reporting companies, regardless of the frequency, would require careful consideration of a variety of related issues, including accounting

<sup>1</sup> See Press Release 2020-95, SEC Forms Cross-Divisional COVID-19 Market Monitoring Group (Apr. 24, 2020), available at <https://www.sec.gov/news/press-release/2020-95>.

implications, exchange rules and market-driven demands for current information from public companies. SEC staff continues to evaluate input from the public, and I look forward to their recommendations.

Rep. Jesús G. “Chuy” García  
 Questions for the Record  
 House Committee on Financial Services  
 Hearing: Oversight of the Securities and Exchange Commission:  
 Wall Street's Cop on the Beat  
 September 24, 2019

**Chair Clayton:**

1. The SEC intended Rule 10b-18 to prevent abusive “purchases designed to support the price of the issuer’s securities in order to assist inside[r]s in disposing of their holdings at or above the pegged price.” Yet there has been a marked lack of enforcement of any attempt at manipulation under Rule 10b-18. According to a 2016 paper by economist William Lazonick, the SEC “has never once investigated the use of insider information on the timing of open-market repurchases for personal gain.” What sort of oversight is the SEC conducting into whether Rule 10b-18’s safe harbor provisions have succeeded in serving the purpose of maintaining restrictions on market manipulation?

**Answer:**

Rule 10b-18 provides a conditional, voluntary safe harbor for issuers that are repurchasing their stock without a manipulative purpose but are concerned that their stock buyback activity could have an inadvertent effect on the market. However, even if an issuer is in technical compliance with the rule, an issuer may not engage in stock buybacks that are fraudulent or manipulative, when viewed in the totality of the facts and circumstances surrounding the repurchases. An issuer that engages in such misconduct may violate the anti-manipulation provisions of the federal securities laws, specifically Sections 10(b) and 9(a)(2) of the Securities Exchange Act of 1934 (Exchange Act), Rule 10b-5 and Regulation M.

In overseeing the securities markets, the Commission actively works to identify and investigate potential misconduct, including fraud or manipulation connected to issuer buybacks.<sup>1</sup> For instance, the Commission’s staff investigates attempts by market participants, including issuers, to artificially affect a security’s market price—whether in “pump-and-dump” schemes in which an issuer, either itself directly or indirectly through others, touts its common stock through false and misleading statements to the market place, or when an issuer is involved in trading to create a false or deceptive picture of the demand for its security. The Commission also

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<sup>1</sup> See, e.g., *SEC v. Wey, et al.*, Civil Action No. 15-cv-7116, S.D.N.Y., filed Sept. 10, 2015 (charging defendants with market manipulation in connection with a stock buyback program under Section 10(b) and Rule 10b-5); see also *SEC v. Competitive Technologies, Inc. et al.*, Civil Action No. 3:04-cv-1331, D. Conn., filed Aug. 22, 2004 (charging defendants with market manipulation in connection with a stock buyback program under Section 10(b) and Rule 10b-5). In *Competitive Technologies*, the court denied defendants’ motion to dismiss based on Rule 10b-18 noting that “actions for manipulation that are predicated on allegations and evidence other than the timing, price, amount, and manner of purchase are not barred by Rule 10b-18.” *SEC v. Competitive Technologies, Inc. et al.*, 2005 WL 1719725, \*3 (D. Conn., July 21, 2005).

investigates and has brought enforcement actions for other alleged misconduct in connection with issuer buybacks, primarily insider trading violations.<sup>2</sup>

Further, as part of its oversight responsibilities, staff across the SEC's divisions and offices is continually evaluating the effectiveness of existing regulations, including Rule 10b-18. Currently, SEC staff are working on a report in response to a directive contained in the Joint Explanatory Statement accompanying the FY 2020 FSGG appropriations act on share repurchases.

2. **Commissioner Jackson has published research showing that executives often time the sale of their personal equity to take advantage of the price increase created by repurchases and their announcement. Another study by Lenore Palladino in a working paper for the Roosevelt Institute found a significant relationship between heightened stock buyback activity and insiders selling their own shares. And there are a number of studies showing that stock buybacks are also more likely when a CEO's bonus is directly linked to earnings per share (Lin 2016; Almeida Fos and Kronlund 2016). In light of these findings, will the SEC examine the question of whether Rule 10b-18's safe harbor provisions have succeeded in serving the purpose of maintaining restrictions on market manipulation?**

**Answer:**

I appreciate the concerns that have been raised regarding stock buybacks and continue to consider them, including with respect to Rule 10b-18.

As a general matter, stock buybacks or share repurchases are not inherently manipulative or negative. Despite discussion about the Commission's role relating to buyback activity, the Commission does not have the authority to prescribe strategic capital allocation decisions, including stock buybacks, and stock buybacks are not—nor have they ever been—restricted by the Commission. The Commission does not regulate capital allocation decisions in the way that other regulators do, such as banking and utility regulators. Whether to engage in buybacks is a business decision that is more appropriately made by a company and its board of directors (which owes a fiduciary duty to the company and all of its shareholders), as opposed to a federal regulator. In fact, a company's decision to return excess cash to shareholders may be most beneficial from a shareholder's perspective when forcing the company to use the cash for other purposes may lead to poor investment or other activities that may not be in the best interests of its shareholders.

If a company determines a stock buyback is appropriate, the SEC's focus is on: (1) market integrity and trading; and (2) investor protection and disclosure regulation. If a registrant

<sup>2</sup> See, e.g., *In re Mizuho Securities USA LLC*, Release no. 34-83685, 2018 WL 3528370 (July 23, 2018) (settled proceeding finding broker-dealer failed to safeguard insider information pertaining to its issuer customers' stock repurchase programs); *SEC v. Wang, et al.*, Civil Action No. 13-cv-02270-L-WVG, S.D. Cal., filed Sept. 23, 2015 (charging defendant with insider trading for trading ahead of company announcement of a stock buyback program); *SEC v. POWELL*, Civil Action No. 6:11-cv-00161, W.D. Tex., filed June 10, 2011 (charging defendant with insider trading for trading ahead of his company's stock buyback initiative); *SEC v. Devlin*, 08-cv-11001 (S.D.N.Y.) (charging registered representative with tipping insider information about stock repurchase program).

determines to conduct buybacks in the open market, the buybacks must not violate the anti-manipulation provisions of the federal securities laws, meaning that registrants may not engage in stock buybacks for the purpose of manipulating or otherwise artificially increasing the price of their securities.

In addition, our laws and regulations prohibiting insider trading, including Rule 10b-5, apply to buybacks as well as sales of stock by company insiders. In short, a company cannot repurchase shares in the open market if it has material, non-public information and an executive cannot sell stock in the open market if she is in possession of material, non-public information. Please note that this prohibition, and its enforcement by the Commission and other authorities, can have the effect of concentrating company buybacks and insider open market sales in the relatively short periods following earnings releases.<sup>3</sup>

In enforcing the anti-manipulation and insider trading provisions of the federal securities laws, the Commission's staff investigates potential attempts by market participants and registrants to engage in insider trading or artificially affect a security's market price—whether in pump-and-dump schemes or when a registrant is involved in trading to create a false or deceptive picture of the demand for its securities. Specifically, the Commission investigates and has brought enforcement actions connected to stock buybacks, including for insider trading.<sup>4</sup>

While some have suggested that Rule 10b-18 is responsible for the surge in stock buybacks, I disagree with that critique. Rule 10b-18 provides a conditional, voluntary safe harbor for issuers that limit the volume and timing of repurchases to mitigate market effects. When these limits are followed, the rule provides a presumption that repurchases are being conducted without manipulation. Rule 10b-18, however, confers no immunity from possible Rule 10b-5 “insider trading” liability where an issuer engages in the repurchases while in possession of material, non-public information concerning its securities.

With regard to investor protection and disclosure regulation, the Commission has adopted rules that specifically require registrants to disclose information about repurchases of registered equity securities. The disclosure requirements are intended to promote transparency about repurchases and the extent to which registrants follow through with publicly announced repurchase plans. The disclosure rules also enable investors to evaluate the use of buybacks on a company-by-company basis, allowing for more informed investor decisions. Commission rules require registrants to disclose all purchases regardless of whether or not such purchases were

<sup>3</sup> For example, model trading policies for companies restrict trading to “window periods” that commence shortly after the quarterly earnings release and terminate prior to the quarter end. See *Our Model Insider Trading Program*, THE CORPORATE COUNSEL, Vol. XXXVI, No. 1 (Jan. – Feb. 2011).

<sup>4</sup> See, e.g., *In re Mizuho Securities USA LLC*, Release No. 34-83685, 2018 WL 3528370 (July 23, 2018) (broker-dealer failed to safeguard inside information pertaining to its issuer customers’ stock repurchase programs); *SEC v. Wang*, No. 13-cv-2270 (S.D. Cal.) (insider used secret offshore account to make unlawful trades based on confidential information about stock repurchase program); *SEC v. Stiefel Laboratories Inc.*, No. 11-cv-24438 (S.D. Fla.) (CEO allegedly defrauded shareholders by using stock repurchase program to buy back stock at severely undervalued prices and then selling the stock to the company at a substantial premium); *SEC v. Devlin*, 08-cv-11001 (S.D.N.Y.) (registered representative tipped inside information about stock repurchase program).

made under the Rule 10b-18 safe harbor. In addition, when senior executives sell stock in the open market, pursuant to Section 16 of the Exchange Act, they are required to publicly disclose the transactions within two business days.

Further, as part of its oversight responsibilities, staff across the SEC's divisions and offices is continually evaluating the effectiveness of existing regulations, including Rule 10b-18. Currently, SEC staff are working on a report in response to a directive contained in the Joint Explanatory Statement accompanying the FY 2020 FSGG appropriations act on the growth share repurchases, and I look forward to reviewing the results of the staff report.

**3. What can investors and proxy advisory firms expect from your upcoming proposed rulemaking on proxy solicitation exemptions? Why are these exemptions worthy of review? Are you considering adjusting the requirements for exemptions (if so, what new requirements are you considering), introducing new exemptions, or removing existing exemptions?**

**Answer:**

In November 2019, the Commission continued its efforts to improve the proxy voting system by proposing amendments to the rules governing proxy solicitations to help ensure that investors who use proxy voting advice businesses receive accurate, transparent and complete information on which to base their voting decisions. It is important to recognize that the proposal would not eliminate the exemptions currently relied upon by these businesses to avoid publicly filing their voting advice. Instead, the proposal would revise these decades-old exemptions to better reflect today's voting process and provide investors with important information in a more efficient and consistent manner.

The proposed amendments would, among other things, enhance the quality of the disclosure about material conflicts of interests that proxy voting advice businesses provide their clients. The proposal would also provide registrants and other soliciting persons an opportunity to review and provide feedback on proxy voting advice before it is issued. Importantly, though, the proposed process would leave the content of the proxy voting advice entirely within the discretion of the proxy voting advice business, which will be under no obligation to make any revisions to the proxy voting advice simply because an issuer provides comments on the advice. The proposed rules would also provide that registrants and certain other soliciting persons may request that proxy voting advice businesses include in their voting advice a hyperlink or similar electronic medium directing the recipient of the advice to a written statement that sets forth the registrant's views on the proxy voting advice. The proposal includes a number of provisions designed to minimize potential disruption in the delivery of the proxy voting advice to investors, such as incentives for registrants to file their proxy materials earlier so that the new requirements will not delay the dissemination of the advice.

The proposal includes an economic analysis that addresses the potential effects of the proposed amendments, including the proposed review and feedback provisions, on efficiency, competition and capital formation. The proposing release also includes a set of questions on which the Commission is soliciting specific feedback, as well as a general request for comment

encouraging interested persons to comment on any aspect of the proposed amendments and to provide in their comments supporting data and analysis. We have received a number of comments on this proposal, and the staff will consider comments received in any recommendations it may make to the Commission with respect to final rules.

4. **During your opening remarks at the August 21st Commission open meeting and vote on the guidance relating to investment advisers, you stated, “These potential actions discussed in the guidance are not new [emphasis added]. They should be familiar to investment advisers and other market participants.”**

**If the guidance is “not new” and simply a restatement of the 2014 SEC Staff Legal Bulletin, then what is the purpose of the guidance? Why was there a need for this recent guidance in the first place?**

**Answer:**

Over the years, the Commission has solicited feedback on, and the staff has previously provided its views regarding, various means investment advisers can use to fulfill their proxy voting responsibilities. For example, in 2010, the Commission issued a concept release on, among other things, the role and legal status of proxy advisory firms within the U.S. proxy system. In 2013, the staff hosted a roundtable on the use of proxy advisory firm services by institutional investors and investment advisers. As you note in your question, in 2014, the staff issued Staff Legal Bulletin No. 20. In 2018, the staff hosted a roundtable on the proxy process, including a panel on the role of proxy advisory firms and their use by investment advisers. In connection with the 2018 roundtable, the public was invited to provide input on questions that arise regarding the use of proxy advisory firms and their activities.

With the benefit of this extensive body of information, historical experience and engagement, the Commission issued guidance regarding the proxy voting responsibilities of investment advisers in a question and answer format similar to the format used by the staff in the Staff Legal Bulletin. While the 2014 Staff Legal Bulletin provided the staff’s views on certain of the questions set forth in the guidance, the guidance includes additional information and provides non-exhaustive examples to help investment advisers’ compliance with their proxy voting responsibilities.

**Commissioner Jackson:**

5. **In response to a question from Rep. Meeks regarding activist hedge funds at closed-end funds, you said you would work with your colleagues at the SEC to “make sure that those ordinary mom-and-pop investors in closed-end funds are protected.” What are some of the policy interventions that the SEC is contemplating to address this issue?**

**Rep. Warren Davidson  
Questions for the Record  
House Committee on Financial Services  
Hearing: Oversight of the Securities and Exchange Commission:  
Wall Street's Cop on the Beat  
September 24, 2019**

**For Chairman Clayton**

- 1. I am concerned that with the current CAT arrangement of numerous SROs and the SEC being able to download bulk data on to their systems, sensitive personally identifiable information may increasingly be compromised. As the CAT is currently designed, thousands of users from the SROs and the SEC could have access to CAT data. How will the SEC control this wide-reaching access and ensure there are no internal data control risks?**

**Answer:**

The SEC remains committed to establishing a fully operational CAT, and it is important that CAT implementation, consistent with the regulatory objectives of the CAT, becomes a reality. A critical step towards doing so is ensuring the protection of sensitive information submitted to the CAT, particularly retail investors' personally identifiable information. The issue has been, and will remain, of paramount importance.

I believe the CAT's regulatory objectives can be achieved without collection of the most sensitive pieces of retail investor information. Doing so will significantly minimize the impact of any potential data breaches, in addition to cybersecurity improvements to the CAT under consideration.

To that end, on March 17, 2020, the Commission issued relief that exempts the SROs (FINRA and the securities exchanges) from collecting or retaining certain retail customer data, including (1) individual social security numbers or individual tax payer identification numbers; (2) dates of birth; and (3) account numbers. Instead of including these most sensitive pieces of personally identifiable information in the CAT, broker-dealers would be required to report an account holder's name, address and birth year. Given the limitation of personally identifiable information to "phone book"-type information, I believe this represents an important step in significantly reducing the risk of retail investor identity theft associated with the CAT.

While the CAT NMS Plan currently has extensive security requirements and our efforts with respect to customer data should significantly reduce certain risks, I believe we can and should consider taking additional steps to ensure the security and confidentiality of CAT data, including in response to developments in data systems and cybersecurity since the 2016 adoption of the CAT NMS Plan. I have asked the staff to prepare a recommendation for the Commission on improving the data security requirements in the CAT NMS Plan this year. In developing the recommendation, I have asked that staff consider the following questions:

- Are there alternatives to “bulk downloading” data by each SRO that would better secure CAT data?
- What are the risks of proliferation of CAT data across multiple environments?
- Are there additional data security issues regarding the use of CAT data for regulatory purposes that should be addressed?
- How will access to customer and account information be addressed to restrict access to the greatest extent possible while still preserving the ability to achieve regulatory purposes?
- Is oversight of Plan Processor security decisions effective and comprehensive?
- To what extent can there be additional transparency regarding the security of CAT and the use of CAT data without making the CAT system vulnerable to bad actors?
- Are there additional security measures that would enhance the security of CAT data, both within and outside of the CAT system?

As we look consider further efforts in this area, I believe we should continue to have data security as our priority while preserving the intended regulatory value of CAT.

2. **With FINRA now serving as the plan processor, can we expect them to be designated as the single SRO responsible for performing cross-market surveillance, therefore limiting full access to CAT data?**

**Answer:**

The CAT NMS Plan includes a requirement that CAT data only be used for regulatory purposes. Nevertheless, I understand this is an area of concern that could be addressed by coordinated regulation by the SROs. In that regard, I note that the CAT NMS Plan approved by the Commission contained a requirement that within twelve months after approval of the CAT NMS Plan, the SROs submit a report detailing their consideration of coordinated surveillance, such as entering into agreements to coordinate regulation under Rule 17d-2 of the Exchange Act and through regulatory services agreements. The SROs submitted the required report on November 15, 2017. In the report, the SROs stated that they believe that for CAT compliance rules, it would be effective to coordinate regulatory surveillance, and that such coordination would both increase the quality of oversight of compliance with the CAT rules and minimize duplicative regulation of SRO members that are members of more than one SRO. I encourage the SROs to continue to work together to consider coordinated surveillance.

**Rep. Anthony Gonzalez**  
**Questions for the Record**  
**House Committee on Financial Services**  
**Hearing: Oversight of the Securities and Exchange Commission:**  
**Wall Street's Cop on the Beat**  
**September 24, 2019**

- 1. Chairman Clayton, what progress is the SEC making on the uncertainty around MiFID II to enable US broker-dealers to continue to compete in the EU after July 2020?**
- 2. Chairman Clayton, what is the SEC doing to stem (and hopefully turn around) the erosion of the availability of research and liquidity in the US capital markets, particularly for small- and mid-cap issuers? Without research and liquidity, I believe it becomes ever-harder for issuers to raise capital in our public securities markets.**

**Answer (Questions 1&2):**

The SEC remains focused on issues related to the availability of research and liquidity in the U.S. capital markets. The production, use and costs of research affect investors, advisory clients, issuers, broker-dealers and investment advisers, and the firms affected range from large, global organizations to local, regional and boutique businesses. As we advance our policy dialogue, it is important to understand the effects of any regulatory options across this range of investors and market participants.

On November 4, 2019, SEC staff in the Division of Investment Management issued an extension until July 3, 2023, of a 2017 no-action letter in which the staff stated that it would not recommend enforcement action if a broker-dealer provides research services that constitute investment advice to MiFID-affected clients and receives payments in hard dollars, through MiFID-governed “research payment accounts,” or a combination of the two, without being considered an investment adviser. The temporary period of the 2017 no-action letter was intended to provide SEC staff and market participants with time to better understand the evolution of business practices after the implementation of MiFID II. Since issuing the 2017 letter, SEC staff has engaged extensively with market participants, received letters regarding the impact of MiFID II on the market for research in the U.S. and Europe, and has monitored developments in Europe that could affect business practices in this regard.

SEC staff has observed that business practices concerning the payments for research continue to evolve, as EU authorities and regulators in individual EU member states evaluate the effects of MiFID II and consider whether to modify their rules. The extended period will allow the staff to continue to monitor and assess the evolving impact of MiFID II and evaluate whether any additional guidance or recommendations to the Commission for regulatory actions are appropriate. We encourage continued engagement from interest parties on this issue.

In addition to addressing issues relating to MiFID II, in November 2018, the SEC adopted rules and amendments, pursuant to the Fair Access to Investment Research Act, designed to promote research on mutual funds, exchange-traded funds, registered closed-end

funds, business development companies and similar covered investment funds. These changes reduce obstacles to providing research on investment funds by harmonizing the treatment of such research with research on other public companies.

3. **Chairman Clayton, you have spent a great deal of time working on cryptocurrency regulation. You have noted that many of the initial coin offerings (ICOs) were sales of securities and thus should have been regulated as such. But these offerings are still considered nonqualifying investments under the current definition of venture capital fund because they may not be perceived as equity securities. So my question is, if you hold that early stage financing of blockchain projects should be considered securities offerings similar to other early stage technology firms, does it then make sense in your view to make these qualifying investments for VC funds as well?**

**Answer:**

Venture capital funds play an important role in entrepreneurial capital formation. The Dodd-Frank Act provided an exemption from SEC registration for investment advisers that manage only venture capital funds. Under the Commission's rules, a venture capital fund must hold at least 80 percent of its capital in qualifying investments. To be a qualifying investment, the investment must be in an equity security, as defined in the Securities Exchange Act of 1934, and generally be issued by a qualifying portfolio company. If under the facts and circumstances, any particular token or coin is an equity security under the Exchange Act and it is issued by a qualifying portfolio company, then that investment would be a qualifying investment.

Importantly, under the Commission's rules, a venture capital fund is permitted to hold up to 20 percent of its capital in non-qualifying investments, including investments that are not equity securities. This 20 percent bucket provides advisers to venture capital funds with greater investment flexibility, while precluding them from altering the character of the fund's investments to such extent that the fund could no longer be viewed as within the exemption's intended scope. To the extent an adviser uses the basket to invest in some non-qualifying investments, it will have less room to invest in others, but the choice is left to the adviser. While the definition limits the amount of non-qualifying investments, it allows the adviser to choose how to allocate those investments.

As the venture capital industry continues to evolve, SEC staff will continue to consider issues related to the scope of qualifying investments for venture capital funds.

4. **Chairman Clayton, I know that encouraging companies to list publicly is one of your top priorities, and I fully support that view. I agree there are too many impediments in place that discourage companies from doing so, and we need to act urgently to change that to ensure retail investors have access to them on the public markets. I know that thresholds for re-submission stand at only 3%, 6% and 10% for shareholder proposals to remain on the ballot after 5 years. I would argue these thresholds are too low and could be raised to a more reasonable level. Secondly, I would argue that the ownership threshold of \$2,000 is probably a bit too low and could be raised and perhaps indexed to inflation thereafter. I believe that standard hasn't changed since the 1990s. Where do**

**you stand on adjusting these thresholds and would you agree this step is one of many needed to encourage companies go public?**

**Answer:**

Improving the proxy process for the benefit of all shareholders is a priority for the Commission. In November 2019, the Commission proposed amendments to Rule 14a-8 to modernize the shareholder proposal submission and resubmission thresholds, which have not been changed in decades. In particular, the proposed amendments would update the current requirement that a shareholder-proponent hold at least \$2,000 of a company's securities with the following three alternative thresholds, any one of which a shareholder could satisfy to be eligible to submit a proposal:

- continuous ownership of at least \$2,000 of the company's securities for at least three years;
- continuous ownership of at least \$15,000 of the company's securities for at least two years; or
- continuous ownership of at least \$25,000 of the company's securities for at least one year.

The proposed amendments to the submission thresholds reflect a recognition that the amount of stock owned by a shareholder is not the only way to demonstrate an interest in the company, particularly for small investors. For this reason, the proposed submission thresholds also take into account the length of time a shareholder has held a company's securities, while keeping the current \$2,000 threshold for shareholders who have held their shares for three years.

The proposed amendments also would amend the current resubmission thresholds of 3, 6 and 10 percent—which have not been updated since 1954—to 5, 15 and 25 percent, respectively, and allow companies to exclude shareholder proposals under certain circumstances where shareholder support for the matter has declined. Said another way, if a shareholder cannot get more than 1 in 20—or 5 percent—of its fellow shareholders to support its proposal in the first year, or more than 1 in 4 shareholders after three years of proxy inclusion within a five-year period, that shareholder proposal would be subject to a limited, company-specific time out under the proposed rules.

We have received a number of comments on these proposals, including suggestions for improving the proposals. The staff will consider comments received in any recommendations it may make to the Commission with respect to final rules.

**Questions for Chair Clayton from Representative Gooden**

1. Does the SEC provide reasoning as to why retail investors that buy ETFs or mutual funds cannot vote their prorata shares of the underlying stock holdings? Has the SEC studied whether that be a more equitable way to structure proxy voting? Has the SEC studied whether a restructure of the proxy voting process, in a way that would allow retail investors that buy ETFs or mutual funds to vote their prorata shares of the underlying stock holdings, would make it easier for their retail investors to opt in or opt out of the fund's ability to vote their prorata shares? If no studies have been initiated, what is the reasoning for not studying the issue?

**Answer:**

The proxy process is a fundamental aspect of our capital markets and one of the primary ways for shareholders to engage with management. In the past two decades, the proxy process has become one of increased complexity and importance to investors, issuers and investment advisers. During this time, investment advisers (including with respect to mutual funds and ETFs) have also assumed a much greater role in our marketplace and, consequently, in the area of shareholder engagement. Over the past several decades, we have seen an increasing number of investors investing through mutual funds and exchange-traded funds (ETFs). Main Street investors seeking exposure to growth-stage issuers benefit from investing through these pooled investment funds, which allow them to diversify their portfolio and rather than bear the risk of holding single issuer securities. As discussed in more detail below, these funds generally vest voting authority with the fund's investment adviser for various reasons, including investment performance and operational efficiency.

Mutual funds are formed as corporations or business or statutory trusts under state law, which must be operated for the benefit of their shareholders. Because a mutual fund is the beneficial owner of its portfolio securities, the fund's board of directors, acting on the fund's behalf, has the right and the obligation to vote proxies relating to the fund's portfolio securities. As a practical matter, however, the board typically delegates this function to the fund's investment adviser as part of the adviser's general management of fund assets, subject to the board's continuing oversight.

An investment adviser to a mutual fund is a fiduciary under the Investment Advisers Act of 1940 (Advisers Act) and owes the fund duties of care and loyalty with respect to actions taken on the fund's behalf, including proxy voting. In particular, an adviser's duty of care requires it, among other things, to have a reasonable understanding of the fund's objectives and to make voting determinations that are in the fund's best interest. In addition, Rule 206(4)-6 under the Advisers Act requires an adviser to adopt and implement written policies and procedures reasonably designed to ensure that client securities are voted in their best interest.

Funds' shareholder bases are typically diffuse and consist primarily of retail investors. By contrast, operating companies' shareholders consist largely of institutional investors who, in general, regularly vote their shares. In addition, funds (such as broad-based index funds) may own hundreds of corporate issuer stocks. During the 2017 proxy season, the average fund voted

on 1,504 proxy proposals for U.S.-listed portfolio companies (excluding companies domiciled outside the United States). The complexity and costs associated with soliciting approvals of the funds' shareholders for potentially hundreds of proposals could be significant. The costs of these proxy campaigns ultimately would be borne by the fund shareholders.

Modernizing and improving the proxy process is a priority for me and some of my fellow Commissioners. The Commission has taken a number of concrete steps in the past year to improve transparency, accountability and functionality in the area of proxy voting in an effort to serve the interests of our long-term Main Street investors. In August 2019, the Commission issued guidance to assist investment advisers in establishing and fulfilling their proxy voting responsibilities, as well as an interpretation that proxy voting advice generally constitutes a "solicitation" under the federal proxy rules and related guidance about the application of the proxy anti-fraud rule to proxy voting advice. Building on these efforts, in November 2019, the Commission proposed amendments to the rules governing proxy solicitations to help ensure that investors who use proxy voting advice businesses receive accurate, transparent and complete information on which to base their voting decisions. On the same date, the Commission also proposed amendments to modernize the rule that governs the process for shareholder proposals to be included in the company's proxy statement. Those proposals included thorough economic analysis of, and requested public comment on, the potential impact of the proposed amendments on efficiency, competition, capital formation, and investor protection. We have received a number of comments on these proposals, including suggestions for improving our proposals, and I expect our work in this area to continue.

- 2. What are fund managers that engage in proxy voting required to disclose to their investors regarding their votes? Has the SEC studied the potential impacts of requiring greater disclosure with regards to the data and information that fund managers who engage in proxy voting use in the time before they cast a vote. If no studies have been initiated, what is the reasoning for not studying the issue?**

**Answer:**

As part of the registration statement, mutual funds that invest in voting securities must disclose the policies and procedures that they use to determine how to vote proxies relating to securities held in their portfolios. This information is required to be delivered to investors upon request and is publicly available on the Commission's EDGAR system.

Mutual funds also file Form N-PX with the Commission, which contains the fund's proxy voting record for the most recent twelve-month period ending June 30. The Commission makes this information public. As part of this disclosure, among other things, a mutual fund must disclose: (1) the name of the issuer; (2) brief identification of the matter voted on; (3) how the matter was voted (e.g. for or against the proposal or abstention); and (4) whether the vote was cast for or against the recommendation of management.

The Commission and the staff recently have taken a number of steps to improve transparency, accountability and functionality of the proxy process, including proposed amendments to the proxy solicitation rules to improve the accuracy and transparency of

disclosures that proxy voting advice businesses provide to their clients about material conflicts of interest. Through this engagement and outreach, which has included public comment and economic analysis, the Commission and staff have carefully considered a number of issues, including the impact of these proposed disclosures on the proxy voting process.

- 3. Does the SEC provide reasoning as to why public companies are not allowed to correct errors in proxy advisory reports prior to release? Does the SEC provide reasoning as to why companies are not given a section in proxy advisory reports to respond to the recommendations? Has the SEC studied the benefits or detriments of a system that allow would allow proxy advisory firms to do this? If no studies have been initiated, what is the reasoning for not studying the issue?**

**Answer:**

In November 2019, the Commission continued its efforts to improve the proxy voting system by proposing amendments to the rules governing proxy solicitations to help ensure that investors who use proxy voting advice businesses receive accurate, transparent and complete information on which to base their voting decisions. The proposal notes that proxy voting advice businesses currently provide limited opportunities for some, but not all, registrants to review and provide feedback on the advice before it is disseminated to clients. The proposal would provide registrants and certain other soliciting persons a more standardized and meaningful opportunity to review and provide feedback on proxy voting advice before it is issued. Importantly, though, the proposed process would leave the content of the proxy voting advice entirely within the discretion of the proxy voting advice business, which will be under no obligation to make any revisions to the proxy voting advice simply because an issuer provides comments on the advice. The proposed rules would also provide that registrants and certain other soliciting persons may request that proxy voting advice businesses include in their voting advice a hyperlink or similar electronic medium directing the recipient of the advice to a written statement that sets forth the views of registrants and certain other soliciting persons on the proxy voting advice.

The proposal includes an economic analysis that addresses the potential effects of the proposed amendments, including the proposed review and feedback provisions, on efficiency, competition and capital formation. The proposing release also includes a set of questions on which the Commission is soliciting specific feedback, as well as a general request for comment encouraging interested persons to comment on any aspect of the proposed amendments and to provide in their comments supporting data and analysis. We have received a number of comments on this proposal, and the staff will consider comments received in any recommendations it may make to the Commission with respect to final rules.

- 4. Has the SEC studied how proxy advisory firms impact the voting process? Has the SEC studied whether the growth of proxy advisory firms has impacted the voting process? If no studies have been initiated, what is the reasoning for not studying the issue?**

**Answer:**

In its November 2019 proposal regarding proxy voting advice businesses, the Commission noted that one of defining characteristics of today's market is the significant role played by institutional investors, which by some estimates own between 70 and 80 percent of the market value of U.S. public companies. The Commission further noted that investment advisers and other institutional investors often retain proxy voting advice businesses to assist them in making their voting determinations on behalf of clients and to handle other aspects of the voting process. The proposing release also provides an extensive discussion of the differing views that registrants, investors, market participants and academics have expressed about the impact of proxy voting advice on the voting process.

The proposing release includes an economic analysis that addresses the potential effects of the proposed amendments on efficiency, competition and capital formation. The release also includes a robust set of questions on which the Commission is soliciting specific feedback, including on the impact of proxy voting advice on the voting process, as well as a general request for comment encouraging interested persons to comment on any aspect of the proposed amendments and to provide in their comments supporting data and analysis. We have received a number of comments on the proposal, and the staff will consider comments received in any recommendations it may make to the Commission with respect to final rules.

- 5. How does the SEC define whether a fund manager that engages in proxy voting has fulfilled their fiduciary duty to their investors? Has the SEC studied the benefits or detriments of fund managers voting proxies automatically without evaluation, also known as "robo-voting"? Has the SEC studied whether this action potentially constitutes a breach of a fund manager's fiduciary duty to their investors? If no studies have been initiated, what is the reasoning for not studying the issue?**

**Answer:**

The fund's board of directors, acting on the fund's behalf, has the right and, in general, the obligation to vote proxies relating to the fund's portfolio securities. As a practical matter, however, the board typically delegates this function to the fund's investment adviser as part of the adviser's general management of fund assets, subject to the board's continuing oversight. An investment adviser to a mutual fund is a fiduciary under the Advisers Act, and the adviser's fiduciary duty extends to all actions taken on the fund's behalf, including proxy voting. In particular, an adviser's duty of care requires it, among other things, to have a reasonable understanding of the fund's objectives and to make voting determinations that are in the fund's best interest. In addition, Rule 206(4)-6 under the Advisers Act, requires an adviser to adopt and implement written policies and procedures reasonably designed to ensure that client securities are voted in their best interest. It should be noted, however, that investment advisers and their clients may scope voting responsibility through informed consent.

Proxy advisory firms may offer the option of pre-populating votes in accordance with specified client voting guidelines on their electronic voting platforms. The Commission guidance regarding the proxy voting responsibilities of investment advisers reminds investment advisers that they must fulfill their fiduciary duty and comply with the requirements of Rule 206(4)-6 when exercising voting authority on behalf of clients, which could include additional

analysis of proxies and review of pre-populated votes. For example, the guidance notes that an investment adviser could consider policies and procedures that provide for consideration of additional information that may become available regarding a particular proposal, such as an issuer's or shareholder proponent's subsequent information that would reasonably be expected to affect the adviser's voting determination. An adviser could also consider a higher degree of analysis where an adviser's voting policies and procedures do not address how it should vote on a particular matter, or where the matter is highly contested or controversial. Further, the guidance suggests that an adviser could sample pre-populated votes to ensure that voting determinations are consistent with the adviser's voting policies and procedures and in the client's best interest.

In connection with its November 2019 proposal regarding proxy voting advice businesses, the Commission considered a number of issues arising from adviser voting, including reliance on pre-populated and automatic voting mechanisms. The release also includes a robust set of questions on which the Commission is soliciting specific feedback, including on whether to limit the use of pre-populated and automatic voting mechanisms, as well as a general request for comment encouraging interested persons to comment on any aspect of the proposed amendments and to provide in their comments supporting data and analysis. We have received a number of comments on the proposal, and the staff will consider comments received in any recommendations it may make to the Commission with respect to final rules.

- 6. What has the SEC done to prevent the potential exploitation of the shareholder proposal process by certain groups that buy a small number of shares and use those shares to propose potentially combative governance proposals. Has the SEC studied in its rule making process the benefits or detriments of instituting a materially higher level of ownership required in order to be eligible to submit shareholder proposals? If no studies have been initiated, what is the reasoning for not studying the issue?**

**Answer:**

In November 2019, the Commission proposed amendments to modernize the rule that governs the process for shareholder proposals to be included in the company's proxy statement. The proposed amendments would replace the current ownership requirements with a tiered approach that would provide three options for demonstrating an ownership stake through a combination of the amount of securities owned and length of time held. Recognizing that the amount of stock owned by a shareholder is not the only way to demonstrate an interest in the company, particularly for small investors, the proposal maintains the long-standing \$2,000 minimum ownership threshold for shareholders provided they have owned their shares for three or more years.

Additionally, the proposed amendments would amend the current resubmission thresholds of 3, 6, and 10 percent—which have not been updated since 1954—to 5, 15, and 25 percent, respectively, and allow companies to exclude shareholder proposals under certain circumstances where shareholder support for the matter has declined. Said another way, if a shareholder cannot get more than 1 in 20—or 5 percent—of its fellow shareholders to support its proposal in the first year, or more than 1 in 4 shareholders after three years of proxy inclusion

within a five-year period, that shareholder proposal would be subject to a limited, company-specific time out under the proposed rules.

The proposed amendments include an economic analysis that addresses the effects of the proposed amendments on efficiency, competition and capital formation. The proposing release also includes a robust set of questions on which the Commission is soliciting specific feedback, as well as a general request for comment encouraging interested persons to comment on any aspect of the proposed amendments and to provide in their comments supporting data and analysis. The staff will consider comments received in any recommendations it may make to the Commission with respect to final rules.

- 7. Commissioner Roisman stated at last month's Open Meeting that, in the context of the proxy firm guidance, he does not "consider fund managers to be the 'investors' that the SEC is charged to protect" and instead that the guidance aims to protect "the ultimate retail investors, who may have their life savings invested in our stock markets." Does the SEC provide reasoning as to how the guidance protects these retail investors from fund managers over-relying on potentially flawed proxy firm recommendations? Has the SEC studied whether more can be done on this issue to protect Main Street investors? If no studies have been initiated, what is the reasoning for not studying the issue?**

**Answer:**

An investment adviser to a mutual fund is a fiduciary under the Advisers Act and owes the fund duties of care and loyalty with respect to actions taken on the fund's behalf, including proxy voting. In particular, an adviser's duty of care requires it, among other things, to have a reasonable understanding of the fund's objectives and to make voting determinations that are in the fund's best interest. In addition, Rule 206(4)-6 under the Advisers Act requires an adviser to adopt and implement written policies and procedures reasonably designed to ensure that client securities are voted in their best interest.

The Commission has taken a number of concrete steps in the past year to improve transparency, accountability and functionality in the area of proxy voting in an effort to serve the interests of our long-term Main Street investors. In August 2019, the Commission issued guidance to assist investment advisers in establishing and fulfilling their proxy voting responsibilities, as well as an interpretation that proxy voting advice generally constitutes a "solicitation" under the federal proxy rules and related guidance about the application of the proxy anti-fraud rule to proxy voting advice. For example, the guidance notes that advisers could consider policies and procedures that provide for consideration of additional information about proxy votes that may become available regarding a particular proposal and could consider whether a higher degree of analysis may be necessary to assess whether votes are cast in the client's best interest. The guidance also discusses how an adviser's policies and procedures should be reasonably designed to ensure that its voting determinations are not based on materially inaccurate or incomplete information, which could include an assessment of the extent to which potential factual errors or methodological weaknesses in the proxy advisory firm's analysis materially affected the research or recommendation used by the adviser.

Building on these efforts, in November 2019, the Commission proposed amendments to the rules governing proxy solicitations to help ensure that investors who use proxy voting advice businesses receive accurate, transparent and complete information on which to base their voting decisions. The proposal included thorough economic analysis of, and requested public comment on, the potential impact of the proposed amendments on the proxy process. We have received a number of comments on this proposal, and the staff will consider comments received in any recommendations it may make to the Commission with respect to final rules.

2019-09-24 Rep. Trey Hollingsworth FC SEC QFR.

1. **Chairman Clayton:** As the venture capital industry has evolved and more companies are staying private longer, secondary investments have become even more important to liquidity in the early stages for a startup. Unfortunately, these investments are considered nonqualifying under the current SEC definition, which is limiting access to capital for our small companies. Last Congress, I introduced legislation that passed out of committee and was included in the JOBS package that would revise the definition to allow venture funds to continue to provide necessary capital for high-growth startups. I understand there is a proposal that would complement this legislation, and I encourage you and your colleagues to review it. Can you commit to a thorough review of this issue?

Answer:

Venture capital funds play an important role in entrepreneurial capital formation. The Dodd-Frank Wall Street Reform and Consumer Protection Act amended the Investment Advisers Act of 1940 to provide an exemption from registration for advisers that manage only venture capital funds. To implement the exemption, the Commission adopted a rule in 2011 defining the term “venture capital fund.”

The rule that implements the venture capital fund adviser exemption allows a 20% bucket for non-qualifying investments. Therefore, a venture capital fund can currently invest in secondary offerings in an amount up to 20% of the fund’s aggregate capital contributions and uncalled committed capital in assets (other than short-term holdings).

The staff will monitor developments in this important area, and discuss with industry and other stakeholders, as the venture capital industry evolves.

2. **Chairman Clayton:** You have previously said the decades-old filing exemptions commonly relied upon by proxy advisory firms warrant a fresh look to determine whether changes are needed. What steps can the SEC take to ensure that proxy firms can continue to play their important role in the marketplace while also protecting Main Street investors from the impact of conflicted recommendations?

Answer:

In November 2019, the Commission continued its efforts to improve the proxy voting system by proposing amendments to the rules governing proxy solicitations to help ensure that investors who use proxy voting advice businesses, who play an important role in the marketplace, receive accurate, transparent and complete information on which to base their voting decisions. We understand that many investment advisers retain proxy advisory firms to perform a variety of functions and services. Some of these are administrative. Other services provided by proxy advisory firms relate to the substance of voting, such as: providing research and analysis regarding the matters subject to a vote; promulgating general voting guidelines that

investment advisers can adopt; and making voting recommendations to investment advisers on specific matters subject to a vote. To help ensure that sufficient information about material conflicts of interest is provided consistently across proxy voting advice businesses, the proposed amendments condition certain exemptions from the proxy solicitation rules to specify that the exemptions will be available to proxy voting advice businesses only to the extent that they include required conflicts of interest disclosures in their proxy voting advice at the time the advice is provided to clients.

The proposal would also provide registrants and other soliciting persons an opportunity to review and provide feedback on proxy voting advice before it is issued. Importantly, though, the proposed process would leave the content of the proxy voting advice entirely within the discretion of the proxy voting advice business, which will be under no obligation to make any revisions to the proxy voting advice simply because an issuer provides comments on the advice. The proposed rules would also provide that registrants and certain other soliciting persons may request that proxy voting advice businesses include in their voting advice a hyperlink or similar electronic medium directing the recipient of the advice to a written statement that sets forth the views of registrants and certain other soliciting persons on the proxy voting advice.

We have received a number of comments on these proposals, including suggestions for improving our proposals, and I expect our work in this area to continue.

**Question from Representative Scott for the Record from September 24, 2019 Hearing  
entitled 'Oversight of the Securities and Exchange Commission: Wall Street's Cop on the  
Beat'**

**Chairman Clayton, I greatly appreciate the SEC's effort to increase the opportunities for working-class Americans to save for their retirement. Recognizing that the main savings vehicle for most Americans is their 401(k) plan, what steps do you think the SEC and other regulators can take beyond the existing harmonization efforts to enhance the opportunities available to 401(k) plan participants, such as private funds and similar vehicles, to help maximize their security for retirement?**

**Answer:**

Until about 25 years ago, the U.S. public markets dominated the private markets in virtually every measure. Today, in many measures, the domestic private markets outpace the public markets, including in aggregate size. One problem with this dynamic is that Main Street investors, including those savings for retirement through their 401(k) plan, generally have access to only public markets—U.S. and, increasingly, international (mostly through products). They have extremely limited, and in many cases, costly and otherwise less attractive, access to our private markets. Investors without access to the private markets are limited in their ability to diversify their portfolios and, as companies stay private longer, investors can lose out on opportunities to participate in company growth and earn a return on investment. This issue is increasingly significant because of changes in the ways that people are saving for retirement. Defined benefit plans, or pension plans, are far less common for today's generation of workers than they were in prior decades. Instead, they have been replaced by defined contribution plans that generally do not have options for their participants to invest in the private markets the way that pension plan custodians can.

The Commission and staff are currently examining ways to facilitate Main Street investors' access to private markets in ways that provide access while maintaining important investor protections. In March 2020, the Commission proposed a set of amendments that would harmonize, simplify and improve the exempt offering framework. The proposed amendments seek to promote capital formation and expand investment opportunities while preserving and enhancing investor protections. The recommendations were informed by feedback we received on a concept release the Commission issued last June seeking public comment on ways to harmonize the overall framework for exempt securities offerings, which included a discussion of retail investor access to pooled investment funds that invest in exempt offerings. The proposed amendments are centered on small and medium-sized companies and seek to address the gaps and complexities in the offering framework that may impede access to capital for these issuers.

We have received many thoughtful comments from the public on the concept release overall, including several addressing specifically the Commission's rules and requirements that may affect 401(k) plan participants' exposure to the private capital markets. SEC staff worked collaboratively with the Department of Labor (DOL) in issuing its Information Letter concerning private equity investments as a component of a professionally managed asset allocation fund offered as an investment option for participants in defined contribution plans. I believe DOL's

Information Letter will provide our long-term Main Street investors with a choice of professionally managed funds that more closely match the diversified public and private market asset allocation strategies pursued by many well-managed pension funds as well as the benefit of selection and monitoring by ERISA fiduciaries. The staff and I will continue to explore possible steps to facilitate greater 401(k) plan participant access to private investments through appropriately structured funds—such as through the inclusion of private investments in retirement target date funds—in a manner that ensures incentive alignment with professional investors, similar to our public markets and otherwise provides appropriate investor protections.

Rep. Sylvia García  
Questions for the Record  
House Committee on Financial Services  
Hearing: Oversight of the Securities and Exchange Commission:  
Wall Street's Cop on the Beat  
September 24, 2019

**DRAFT PCAOB QFRs**

1. Commissioner Jackson: When the SEC files civil or administrative charges, the charges are disclosed to the public, and the ensuing enforcement proceedings unfold in public. In the criminal justice system, though defendants are presumed innocent until proven guilty, indictments and trials are also public.

Yet, under the Sarbanes-Oxley Act of 2002, PCAOB enforcement charges, hearings, and related proceedings are hidden from public view while they run their course. Senator Grassley recently stated that “this secrecy provides incentives to bad actors to extend the proceedings as long as possible so they can continue to do business without notice to business about potential problems with a particular auditor.” He pointed to a situation in which an accounting firm that was subject to a disciplinary proceeding issued 29 additional audit reports on public companies without any of those companies knowing about the ongoing PCAOB disciplinary proceedings. Testifying before the Senate Banking Committee, Former PCAOB Chairman James Doty himself said that this lack of transparency “is not good for investors, for the auditing profession, or for the public at large” and that “investors would be best served by similar transparency in PCAOB disciplinary proceedings.”

- Do you believe that the secret nature of PCAOB proceedings create risk or value for the market and investors?
  - Do you see a reason to treat PCAOB disciplinary hearings differently from SEC enforcement proceedings?
  - Would the public interest be served by making PCAOB enforcement proceedings as transparent as SEC enforcement proceedings? Why or why not?
- 
2. Commissioner Jackson: According to a report by the Project on Government Oversight, PCAOB inspections have identified 808 instances in which the U.S. arms of the largest audit firms mismanaged audits to a degree that firms should not have certified a company’s financial statements and/or internal controls. However, over its entire history, the PCAOB has disclosed only 18 enforcement actions against those audit firms or employees of those firms. The 18 enforcement actions involved a total of 21 audits, POGO reported.
- In your view what accounts for the disparity between the number of violations identified in PCAOB inspection reports and the number that have led to enforcement actions?

- How do you reconcile POGO's findings with the PCAOB's statutory responsibilities?
3. **Commissioner Jackson:** According to POGO, if the 808 audits cited as fatally flawed in PCAOB inspection reports were as bad as the reports said, it appears that the PCAOB could have fined the audit firms more than \$1.6 billion. That conservatively assumes that each violation qualified only for the lowest tier of fines the PCAOB was legally empowered to impose.

Yet, over its entire history, the PCAOB has fined the largest four U.S. audit firms a total of just \$6.5 million, or less than one half of one percent of the potential fines.

- To what do you attribute this disparity?
  - In your opinion are the fines that the PCAOB has levied against audit firms to date been at a level that provides an effective deterrent?
4. **Commissioner Jackson:** In December 2017, a federal judge found that PricewaterhouseCoopers had violated its professional duties over a period of years by negligently auditing Colonial BancGroup, the parent company of Colonial Bank. Colonial Bank had been the victim of a massive mortgage loan fraud. It had allegedly bought large quantities of "what amounted to fictitious assets"—including loans that didn't exist or had already been sold to others. It was placed in FDIC receivership in 2009 and, by the end of 2018, had cost an FDIC insurance fund \$3 billion. "The Court concludes that PwC did not design its audits to detect fraud and PwC's failure to do so constitutes a violation of the auditing standards," U.S. District Court Judge Barbara Jacobs Rothstein said in her December 2017 decision.

Despite this judicial find there is no public record of any SEC or PCAOB enforcement action against PwC or anyone associated with PwC in connection with PwC's audits of Colonial. Similarly, there is no public record of any SEC or PCAOB enforcement action against PwC or anyone associated with PwC in connection with PwC's audits of MF Global, which collapsed disastrously.

- Given the lack of action in two high profile case do you believe the PCAOB being as aggressive as it ought to be in enforcing auditing standards.
- Should a judicial finding that an auditing firm had violated auditing standards result in an automatic referral to the PCAOB or the SEC for action?

5. **Chairman Clayton: Given that the PCAOB is subordinate to the SEC, what is the appropriate level of review the SEC should take in reviewing the Board's actions and non-actions?**

**Answer:**

The PCAOB was created by the Sarbanes-Oxley Act of 2002 in the wake of corporate and accounting scandals that cost investors billions of dollars. The PCAOB's mission is focused on a specific aspect of our capital markets ecosystem—preserving and improving the quality and reliability of public company audits and the audits of SEC-registered brokers and dealers for the protection of investors. Audited financial statements are at the heart of the SEC's disclosure-based regulatory regime: a company's financial statements provide investors with a wealth of material information, including quantitative information that informs more qualitative disclosures. The requirement of an independent audit of those financial statements works to improve their quality and provides investors with additional comfort that those statements were prepared properly and are accurate. Oversight of the PCAOB is an important Commission function.<sup>1</sup>

The Commission's oversight of the PCAOB includes the selection and removal of the Board members. The Commission's oversight of the Board also includes, among other items, the authority to: (1) approve the budget and manage the operations of the Board and the staff of the Board; (2) review disciplinary actions by the Board and, as appropriate, modify or cancel the sanction; (3) amend the rules of the Board; (4) rescind Board authority; (5) censure the Board or remove a Board member; and (6) require the Board to perform such other duties or responsibilities as the Commission determines are necessary to promote high professional standards and improve the quality of audit services.

The Board is also subject to statutorily-mandated coordination with the Commission on enforcement matters. The Board is required to notify the Commission of any pending Board investigation involving potential violations of the securities laws, and thereafter, coordinates its work with the work of the SEC's Division of Enforcement, as necessary, to protect any ongoing SEC investigation. Additionally, the PCAOB sends referrals to the Commission when the Board determines that its staff has identified possible violations of, among other things, the federal securities laws or the PCAOB's rules.

In recent years there have been a number of operational and other challenges at the PCAOB. Although I believe significant progress has been made, the Commission should continue to devote greater attention and resources to its oversight of the PCAOB.

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<sup>1</sup> Commissioner Allison Herren Lee has recused herself from PCAOB matters because her husband is a Board member.

6. **Chairman Clayton: Positions taken by some foreign authorities currently significantly impair or outright prevent the PCAOB's ability to inspect non-U.S. audit firms in foreign countries, yet these companies are still able to be traded in U.S. public markets. For example, the PCAOB is currently restricted from inspecting audit work and practices of PCAOB-registered firms in China.**

- **Are you concerned that these foreign companies, particularly Chinese companies, are using foreign laws to circumvent U.S. legal requirements while unfairly accessing U.S. capital markets?**
- **What are appropriate actions, if any, to remedy this situation?**

**Answer:**

Over the past decade, U.S. investors, and the U.S. capital markets more generally, have increased exposure to companies with significant operations in emerging markets, including China—the largest emerging market and the world's second largest economy. Investments in emerging markets, including China, entail significant disclosure, financial reporting and other risks for U.S. investors. Significantly, while the U.S. securities laws and regulations applicable to emerging market companies listed on U.S. exchanges are the same as (or comparable to) the laws and regulations applicable to U.S. public companies, the practical effects are substantially different, based on the inability of U.S. regulators to inspect for compliance and enforce these rules and regulations. This is a fundamental issue in emerging market investing that I believe investors, particularly our Main Street investors, should better understand. This status quo of an unlevel playing field for issuers from certain emerging markets is unacceptable. I am committed to working with Congress and the Administration through the President's Working Group on Financial Markets to address these impacts on investors.

In order to bring greater attention to these risks, SEC staff and I, along with the Chairman of the Public Company Accounting Oversight Board (PCAOB), have issued several joint statements outlining the significant risks related to investments in China due to the inability of the PCAOB to inspect audit work and practices of PCAOB-registered accounting firms in China. Investors should understand the potential impacts of the PCAOB's lack of access when investing in companies whose auditor is based in China or where significant portions of the audit may have been performed by firms in China. The PCAOB periodically publishes a list of U.S.-listed companies where the PCAOB faces obstacles in inspecting the principal auditor's work. Given the importance to investors of understanding the potential material risks related to the PCAOB's lack of access related to PCAOB-registered accounting firms in China, issuers with operations in China should make clear disclosures regarding these risks, including highlighting these limitations as a risk factor, and some issuers disclosing the risk in their annual report that their auditors are not fully inspected by the PCAOB and, as such, shareholders do not receive the benefits of such inspection.

Recognizing the difficulties we face with inspection and enforcement, we have also engaged with U.S. auditing firms including certain of their global network representatives regarding the significance of their work and the importance of their diligence efforts with respect to their work in China. While these discussions with the audit firms are not intended to be a substitute for the PCAOB inspecting audit work and practices of PCAOB-registered accounting firms in China with respect to their audit work of U.S.-listed companies, these meetings have

included discussions regarding audit quality across their global networks and the importance of effective and consistent oversight of member firms globally, including those operating in China and other emerging markets. In each of these meetings, the audit firms have recognized their responsibilities as auditors and acknowledged the importance of consistent audit methodologies across their global networks, and we were clear in sharing our expectations that they fulfill these responsibilities.

In addition to these meetings and public statements, there is a broader, continuing dialogue with U.S. audit firms and network representatives regarding the importance of effective and consistent oversight of member firms globally, including those operating in China and other emerging markets. The PCAOB has been in negotiations with foreign audit regulators in certain countries, including China, that currently prevent or constraint the PCAOB from carrying out its inspection process with respect to the audits of companies by audit firms based in those countries. Even while these negotiations are ongoing, a refusal to cooperate by an audit firm—either in an inspection or an investigation—could subject the firm to SEC or PCAOB sanctions and remedial measures. Having the ability to impose sanctions and remedial measures may enhance the ability to make further progress with respect to such negotiations, but the imposition of such measures needs to be balanced with their potential impact on investors and the broader capital markets.

Depending on various facts and circumstances, including company-specific considerations, if significant barriers to effective inspections and regulatory oversight continue to exist in certain jurisdictions, remedial actions that involve or affect U.S.-listed companies with significant operations in those jurisdictions may be necessary or appropriate. There is a spectrum of potential actions. In the past, remedial measures have included, as examples, requiring affected companies to make additional disclosures, placing additional restrictions on new securities issuances and the adoption of more prescriptive, accountability-oriented listing standards. Some have suggested additional measures, including requiring the delisting of U.S.-listed companies who are audited by firms that the PCAOB is not sufficiently able to inspect or investigate, as well as the deregistration of audit firms themselves.

To further promote engagement and help inform our consideration of these issues, the SEC will be holding a roundtable to hear the views of investors, other market participants, regulators and industry experts on how we can continue to raise investor awareness of these risks and explore potential additional steps that can be taken to mitigate them. The ability to inspect for and enforce our laws and regulations is of paramount importance to U.S. investors and our capital markets more generally. I believe the status quo is unacceptable and look forward to continuing to work with Congress to ensure transparency and confidence in our markets.

Rep. Steve Stivers  
Questions for the Record  
House Committee on Financial Services  
Hearing: Oversight of the Securities and Exchange Commission:  
Wall Street's Cop on the Beat  
September 24, 2019

1. "Chairman Clayton, over eight years, the Federal Reserve accumulated a lot of regulatory power, mostly as the result of the Dodd-Frank Act. That regulatory power, in some instances even extended extra-territorially where the U.S. regulators tried to gold plate the G20 agenda through the Financial Stability Board. As a general matter, do you agree that the market regulators, in particular the SEC and CFTC, should be the primary regulators of the capital markets since they regulate for risk-taking rather than safety and soundness, which is the role of banking regulators."

**Answer:**

Yes. The SEC, together with the U.S. Commodity Futures Trading Commission (CFTC), is the primary regulator of the U.S. capital markets, and we have developed significant expertise over the years in regulating these markets. The SEC shares oversight of the broader financial services industry with other financial regulators charged with overseeing related or overlapping financial activity and market participants.

It is, of course, important for other regulators to be sensitive to the effects of their regulatory regimes and actions on the capital markets and market participants. In this regard, my experience to date is that the Financial Stability Oversight Council's (FSOC) members, including the Federal Reserve and other prudential regulators, generally recognize that the federal regulatory members operate under distinct statutory mandates and have different regulatory missions. Despite these differing mandates and expertise, increasingly interconnected nation of our financial system requires extensive collaboration among the financial regulatory agencies. I am able to share with the FSOC's members my perspective about potential impacts of current and proposed regulations of other regulatory bodies on capital markets, and our respective staffs also have ongoing engagement on such matters.

On the international front, the SEC is a member of the Financial Stability Board (FSB), along with the U.S. Treasury and the Federal Reserve. In multilateral forums such as the FSB, it is important for discussions about risks to be informed by an in-depth understanding of the interconnectedness between the banking system and capital markets. As part of FSB discussions, the SEC shares its perspective and experience as a capital markets regulator.

Rep. Ann Wagner  
 Questions for the Record  
 House Committee on Financial Services  
 Hearing: Oversight of the Securities and Exchange Commission:  
 Wall Street's Cop on the Beat  
 September 24, 2019

1. **Chairman Clayton, some have criticized Regulation Best Interest by saying not enough investor testing was conducted. However, the SEC completed extensive investor testing in advance of finalizing the rule, including 1800 surveys of investors nationwide. What did the investor testing show, and what would your response be to those critiques?**

**Answer:**

As part of its standards of conduct rulemaking package, the Commission adopted Form CRS, known as the “relationship summary.” Form CRS is designed to reduce retail investor confusion about brokerage and investment advisory services and assist retail investors as they decide whether to engage a particular firm or financial professional. In developing Form CRS, the Commission considered an unprecedented amount of investor input and testing, which substantially informed the final form’s approach. For example, the Commission heard first-hand from Main Street investors in seven roundtables across the country and in response to a new “Tell Us” website designed to obtain retail investor insights and feedback. The Commission’s Office of the Investor Advocate (OIA) engaged the RAND Corporation to conduct qualitative and quantitative investor testing of the proposed relationship summary. The Commission also considered information provided by commenters, some of which included additional investor testing, and the staff leveraged their considerable experience with investor disclosures.

Through this outreach, we learned about areas of investor confusion about services, fees, conflicts of interest and the required standard of conduct for firms, as well as differences between brokers and advisers. Investors told us that the relationship summary would help them make more informed choices when deciding among options, and investors that participated in interviews as part of RAND’s investor testing demonstrated learning new information from reviewing the relationship summary. This investor input significantly improved Form CRS in the final Commission action.

I believe the new Form CRS relationship summary provides a level of transparency and comparability across SEC-registered investment advisers, broker-dealers and dual registrants that the existing retail disclosures do not provide, helping investors to find additional information easily. The relationship summary also helps maintain choice—a key goal of the standards of conduct rulemaking package—because investors can now see what is available to them and compare. The Commission also directed staff to review a sample of relationship summaries that will be filed on or by June 30, 2020, to confirm that Form CRS fulfills its intended purpose.

2. **Regulation Best Interest establishes a uniform standard of conduct for broker-dealers to act in the best interest of their clients, including mitigating, not just disclosing,**

**conflicts of interest. Chairman Clayton, can you further discuss how broker-dealers will be required to handle conflicts of interest under Reg BI?**

**Answer:**

Regulation Best Interest is based on the fundamental principle that financial professionals should not put their interests ahead of the interests of their clients and customers. Regulation Best Interest designed to improve investor protection by enhancing the quality of broker-dealer recommendations to retail customers and reducing the potential harm to retail customers that may be caused by conflicts of interest. To do so, Regulation Best Interest requires broker-dealers to address conflicts of interest. Specifically, the disclosure obligation requires broker-dealers to fully and fairly disclose in writing, prior to or at the time of the recommendation, all material facts relating to conflicts of interest that are associated with the recommendation. The conflict of interest obligation requires broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed to identify, and at a minimum, disclose or eliminate conflicts of interest. This obligation requires policies and procedures to:

- Identify and mitigate conflicts that create an incentive for the firm's financial professionals to place their interest or the interests of the firm ahead of the retail customer's interest;
- Identify and disclose material limitations on offerings, such as a limited product menu or offering only proprietary products, and prevent such limitations from causing the firm or its financial professional to place his or her interest or the interest of the firm ahead of the retail customer's interest; and
- Identify and eliminate sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period of time.

While disclosure can be an effective tool to increase awareness of conflicts of interest, the conflict of interest obligation reflects the Commission's belief that in certain cases disclosure alone does not sufficiently reduce the potential effect of incentives that directly affect the associated person making the recommendation and are most likely to undermine the associated person's ability to make a recommendation that is in the best interest of the retail customer. Therefore, the rule requires that such conflicts be addressed through policies and procedures reasonably designed to mitigate conflicts of interest that create an incentive for an associated person of the broker-dealer to place its interests or the interest of the firm ahead of the retail customer's interest.

Further, broker-dealers will also need to establish, maintain and enforce policies and procedures reasonably designed to eliminate any sales contests, sales quotas, bonuses and non-cash compensation that are based on the sales of specific securities or specific types of securities within a limited period of time. These practices, particularly when coupled with a time limitation, create high-pressure situations for associated persons to engage in sales conduct contrary to the best interest of retail customers, and the conflicts created by these practices are in direct opposition to our goal of reducing the effect of conflicts of interest on broker-dealer recommendations.

3. **Main Street Americans deserve affordable and accessible financial advice that will ensure they can be prosperous and financially sound well into their retirement years. Chairman Clayton, can you discuss how the SEC's Regulation Best Interest will ensure that Mom and Pop investors get the financial advice they deserve and help them make more informed decisions?**

**Answer:**

Regulation Best Interest is a key part of a comprehensive package of rules and interpretations that the Commission adopted in June 2019 that will enhance the quality and transparency of the relationships that Main Street investors have with broker-dealers and investment advisers. At a high level, this comprehensive package: (1) requires broker-dealers to act in the best interest of their retail customers; (2) requires both broker-dealers and investment advisers to state clearly key facts about their relationship, including their financial incentives in a short-form relationship summary; (3) reaffirms, and in some instances clarifies, the fiduciary duty owed by investment advisers to their clients; and (4) more clearly delineates when a broker-dealer's performance of advisory activities causes it to become an investment adviser subject to registration under the Investment Advisers Act. Collectively, these regulatory actions bring the legal requirements and mandated disclosures for broker-dealers and investment advisers in line with reasonable investor expectations, while preserving retail investor access (in terms of both choice and cost) to a variety of investment services and products.

More specifically, Regulation Best Interest creates an enhanced standard of conduct applicable to broker-dealers at the time they recommend to a retail customer a securities transaction or investment strategy involving securities (including account recommendations). When making a recommendation, a broker-dealer must act in the retail customer's best interest and without placing its own interests ahead of the customer's interests. To meet the "best interest" obligation, broker-dealers must comply with four component obligations: (1) a disclosure obligation, (2) a care obligation, (3) a conflict of interest obligation and (4) a compliance obligation.

The Commission also adopted requirements for a new disclosure called the customer or client "Relationship Summary" (Form CRS) that investment advisers and broker-dealers will be required to deliver to retail investors at the beginning of their relationship. Firms will be required to summarize information about services, fees and costs, conflicts of interest, legal standard of conduct and whether or not the firm and its financial professionals have disciplinary history. Form CRS will have a standardized question-and-answer format to promote comparison by retail investors in a way that is distinct from existing disclosures and will permit the use of layered disclosure so that investors can more easily access additional information from the firm about these topics. It also will highlight the Commission's investor education website, Investor.gov, which offers the investing public educational information, including a series of educational videos designed to provide ordinary investors with some basic information about broker-dealers and investment advisers.

Without question, these actions, individually and collectively, will significantly benefit Main Street investors.

