CAPITAL MARKETS AND EMERGENCY LENDING IN THE COVID-19 ERA

VIRTUAL HEARING

BEFORE THE

SUBCOMMITTEE ON INVESTOR PROTECTION, ENTREPRENEURSHIP, AND CAPITAL MARKETS

OF THE

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CAPITAL MARKETS AND EMERGENCY LENDING IN THE COVID-19 ERA

Thursday, June 25, 2020

U.S. House of Representatives,
Subcommittee on Investor Protection,
Entrepreneurship, and Capital Markets,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 12:06 p.m., in room 2128, Rayburn House Office Building, Hon. Brad Sherman [chairman of the subcommittee] presiding.

Members present: Representatives Sherman, Maloney, Himes, Foster, Meeks, Vargas, Gottheimer, San Nicolas, Porter, Axne, Casten; Huizenga, Stivers, Wagner, Hill, Mooney, Davidson, Hollingsworth, Gonzalez of Ohio, and Steil.

Ex officio present: Representatives Waters and McHenry.

Also present: Representatives Dean, Garcia of Texas; and Budd.

Chairman Sherman. The Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Also, without objection, members of the full Financial Services Committee who are not members of the subcommittee are authorized to participate in today's hearing, as long as they participate virtually. And they will be recognized after members of the subcommittee have been recognized.

Members who are participating via the Webex platform are reminded to keep their video function on at all times, even if they are not being recognized by the Chair.

Members who are participating via the Webex platform are also reminded that they are responsible for muting and unmuting themselves, and that they should mute themselves both before and after the time that they are allotted. But in addition to that, consistent with regulations accompanying H. Res. 965, staff will also be muting Members when they are not being recognized.

Members are reminded that all House rules relating to order and decorum apply to this hybrid hearing.

In addition, the Chair informs members participating in person that, in enforcing the order and decorum in this hearing room, the Chair has the duty to protect the safety of the Members. Last week, the Attending Physician provided the following guidance: "For U.S. House of Representatives' meetings in limited enclosed spaceS—and this is one—such as a committee hearing room, for greater than 15 minutes, face coverings are required." Accordingly, the Chair will treat wearing masks as a matter of order and decorum, and all Members should wear masks at all times in this room. Members who do not wish to wear masks may participate virtually through the Webex platform.

Today's hearing is entitled, "Capital Markets and Emergency Lending in the COVID-19 Era."

Mr. HUIZENGA. Mr. Chairman? I have a point of inquiry on that.

Chairman SHERMAN. Yes?

Mr. HUIZENGA. It was my understanding, based on the rules, that masks were required unless you were speaking, and during your question period. That was my understanding, so I just want to make sure it is clear for our—

Chairman SHERMAN. It is the strong preference of the Chair that we wear the masks even while speaking, but that rule will be less enforced than at other times.

The reason for that is, if you are not wearing a mask before you speak, you may not be called on in order. But, once I call on someone, we will rely upon your dedication to the health of yourself but, more importantly, everyone else in the room, and urge you to continue wearing your mask.

You are, as we have seen from a number of instances, more likely to spread the disease when speaking than when not speaking. So I would urge you to do so, but my tools for enforcing that are more limited.

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

And to my Members, I advise your comfort level, and then, as we are dealing with this, much like the rules on the House Floor, if you are speaking, I think we are free to add to the comfort level, being able to deal with that.

So, thank you. I yield back.

Chairman SHERMAN. Okay.

Accordingly, the Chair will treat wearing masks as a matter of order and decorum, and all Members should wear masks. Members who do not wish to wear masks, as I have said before, may participate virtually.

I will now recognize myself for 4 minutes.

Mr. Clayton, I am glad you are here. I hope you are here 6 months from now. It has been suggested that, as part of the President's decision to fire the U.S. Attorney for the Southern District in New York, you would be called upon to fill that position.

I rarely quote Senators, because they are rarely a source of wisdom, but in this case, Chuck Schumer stated that, "Jay Clayton can allow himself to be used in this brazen Trump-Barr scheme to interfere with the investigations by the U.S. Attorney for the Southern District of New York, or he can stand up, withdraw his name from consideration, and save his reputation."

I don't always take advice from Senators, but in this case, I would commend it to you, especially in light of the fact that Senator Lindsey Graham has pretty much indicated that, "you are with us for the duration." So, keeping your name there simply weakens your gravitas with regard to the SEC and doesn't allow you to reduce your commute.

The COVID-19 pandemic has resulted in unprecedented volatility in U.S. markets, yet the markets have remained open; they are functioning. I know the Chair will tell us everything his staff has done to achieve that result, and that the SEC Division of Enforcement and Office of Compliance Inspections and Examinations have also moved aggressively to stop COVID-19-based investment scams and have already suspended trading of 30 companies.

We are in a time of emergency, so I would hope that the SEC would use its limited bandwidth to do two things: one, the things that are necessary because of the emergency; and two, the things that are bipartisan. Accordingly, I would hope that you would curtail the efforts on the Proxy Advisor Rule and the rules that would narrow disclosure related to mergers and acquisitions.

Today, we are going to be dealing with a number of bills, including: Ms. Velazquez's bill to require public companies to disclose risks to the supply chain, disruptions and impacts and what impact they may have on their workforce; Ms. Dean's legislation to reverse the Federal Reserve's and Treasury's decision to open Federal Reserve lending facilities only to corporations with credit ratings from certain agencies or having at least one of those certain credit-rating agencies, when, in fact, the SEC has determined that a longer list of agencies have expertise; Ms. Wexton's bill to require disclosure of products likely to be manufactured using forced labor from the Uyghur internment camps—and this is a group, of course, that the President was so anxious to sell out, but I don't think that should be our policy; and Mr. Meeks' legislation to temporarily suspend rulemaking by Federal fiscal regulators unrelated to the COVID-19 crisis.

We will also discuss a number of issues that I have legislation on, along with my bipartisan cosponsors. Among these are: the need for continued public disclosure of those unique risks that companies have because of COVID-19; the ongoing barriers to the Public Company Accounting Oversight Board (PCAOB) and its effort to audit the auditors and make sure that investors are protected; continued challenges with the flawed Current Expected Credit Losses (CECL) accounting standard, and that the overall push at the Financial Accounting Standards Board (FASB) needs to be controlled by the SEC to move from historic accounting and reporting what has happened in transactions that have been completed, to moving to having the accountants project what is likely to happen or to determine what future values of certain assets will be; and the misguided decision by the Fed and Treasury to exempt companies receiving taxpayer dollars from the rules we put in the Coronavirus Aid, Relief, and Economic Security (CARES) Act regarding dividend payments and stock buybacks and executive compensation. And we will also be dealing with the loan covenant issue that arises at this time.

I look forward to hearing from Chairman Clayton on these issues.

And I will now yield 4 minutes to the ranking member of the subcommittee, Mr. Huizenga.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate you holding today's hearing, "Capital Markets and Emergency Lending in the COVID-19 Era."

I will note that this hearing is not about the Southern District of New York. And now that that box has been checked, I hope we can move along to the work of Chairman Clayton.

The last several months have upended the livelihood and well-being of millions of American families throughout the United States. With almost every State under stay-at-home orders, everyone has been affected by the pandemic. Not only has this affected our daily lives, but it has certainly impacted our capital markets as well.

Undoubtedly, these have been uncertain times for American investors and market participants. During the first quarter of 2020, the pandemic caused severe economic and capital market shocks. This turmoil was evidenced by sharp price declines, yet spikes in volumes in equity markets, which closed the first quarter with their worst performance since the financial crisis. Additionally, the ultimate symbol of these unprecedented times was the March 23rd closing of the floor of the New York Stock Exchange, which was the first time the floor was closed while electronic trading continued.

Although we saw significant market volatility early in the crisis, I believe that capital markets have been generally resilient. Our capital markets have undergone the toughest pandemic stress test to date, and I am pleased to report that they seemed to pass with flying colors.

As we are beginning to emerge from the depths of this health crisis, we have a unique opportunity to carefully assess the actions taken to address the pandemic and its impact. We should take stock of the lessons learned in how we might improve and modernize moving forward.

We need to find more ways to jump-start our economy, help grow our small businesses, and reduce unnecessary regulatory costs and burdens on our public companies. We must also improve and expand access to the capital markets for both businesses and investors in order to better put their money to work.

There is no doubt that many of COVID-19's impacts will be long-lasting, and that will necessarily influence how America conducts business in the foreseeable future.

Chairman Clayton, I look forward to hearing from you today on ways to reignite the economy and help businesses get back up and running, as well as to get Americans back to work, not to mention what you often talk about as, "protecting Main Street investors." And we need those folks to increase savings and retirement returns for these Main Street Americans.

So I am looking forward to hearing from you, as we have chatted in the past. Many things are happening, and I hope that we will be able to capture some of the temporary reforms and streamlining, as economists talk about reducing that friction between transactions in a way that certainly keeps investors safe, facilitates the markets, and increases the value and the importance here in the United States.

And, with that, Mr. Chairman, I yield back.

Chairman SHERMAN. Thank you.

At this point, I would normally yield to the Chair of the Full Committee, if she were available. But instead, I will go to the ranking member of the Full Committee, and the Chair of the Full Committee will be recognized either after the ranking member or after the witness.

I now recogize Ranking Member McHenry for 1 minute.

Mr. McHENRY. Sure. And I am happy to take her time, but not her perspective. Thank you.

Thank you, Chair Clayton, for being here. I know there is exciting news about you, and what the Securities and Exchange Commission is doing, so I am glad we can talk about those things here today.

I commend your leadership and the Commission's diligence during these tough times. The constant, focused work that you all have been doing is commendable. This gives assurance to markets and to the American people that our government can actually function, even in a time where we have to be socially distant.

We need to ensure that regulators like the SEC are focused on policies to make our markets stronger, more attractive, and more competitive to see our way through this economic challenge borne out of this health crisis.

I know the Commission has made a lot of progress on proposals to stimulate the economy and economic growth, and to prioritize targeted reforms to address the current needs related to the virus.

So, thank you for your leadership, thank you for being here, and thank you for your good work.

Chairman SHERMAN. Thank you.

Again, I will reserve 1 minute for the Chair of the Full Committee, Chairwoman Waters.

Now, we welcome the testimony of our distinguished witness, Jay Clayton, Chairman of the U.S. Securities and Exchange Commission.

Chair Clayton has served as Chair of the SEC since 2017. And, during that time, he also has served as a member of the President's Working Group on Financial Markets, the Financial Stability Oversight Council, and the Financial Stability Board—clearly a package of responsibilities that exceeds an interest in anything else that he is considering doing.

Chair Clayton has testified before this committee before, so I don't believe he requires more of an introduction.

The witness is reminded that your oral testimony will be limited to 5 minutes. And without objection, your written statement will be made a part of the record.

You are now recognized for 5 minutes.

STATEMENT OF THE HONORABLE JAY CLAYTON, CHAIRMAN, U.S. SECURITIES AND EXCHANGE COMMISSION (SEC)

Mr. CLAYTON. Thank you, Chairman Sherman, Ranking Member Huizenga, and members of the subcommittee. I appreciate the opportunity to testify today.

Before I begin discussing the work of the Commission, I would like to address briefly the recent news regarding my potential nomination to be the U.S. Attorney for the Southern District of New York.

I have a long-held, deep respect for the work of the Southern District, which is recognized throughout our nation and internationally for enforcing the law and pursuing justice without fear or favor. My deep personal respect is largely the result of many years of working with the Southern District and its distinguished alumni, including senior personnel at the SEC.

I recognize that the nomination process is multifaceted and uncertain. It is clear the process does not require my current attention. In short, I am fully committed to and focused on my role at the SEC.

I could not be more proud of the work of my colleagues over the past 3 years on behalf of Main Street investors and our market. There is much more to accomplish in an environment that emphasizes a commitment to respect, diversity, inclusion, and opportunity for all, and I look forward to continuing to lead the Commission.

Today, my testimony will focus solely on the work of the SEC, and in particular, the SEC's important work in responding to the effects of COVID-19.

Our efforts have focused, first and foremost, on the health and safety of our employees and of all Americans. Since early March, the agency has remained fully operational in a mandatory telework posture, thanks to the dedicated women and men of the agency who have risen to the occasion, demonstrated flexibility and resiliency, and proven why their work is so important to Main Street investors and to our market.

In these times of economic stress and market volatility brought about by our collective, unprecedented health and safety response to COVID-19, the Commission has focused significant resources on ensuring that our markets continue to function as expected: facilitating timely, decision-useful disclosure; and maintaining our enforcement, examination, and investor protection efforts.

We have worked closely with our fellow regulators over the past few months, and I believe our collective efforts to preserve the flows of credit and capital in our economy has significantly mitigated the potential economic consequences of COVID-19.

I would be remiss here if I did not mention the prompt, decisive action of the Federal Reserve, the Treasury, and Congress. From my vantage point, these efforts were necessary and had their intended stabilizing and other effects.

Here, I note that despite the extraordinary volumes in volatility we have seen over the past few months, the pipes and plumbing of our securities markets have functioned largely as designed and, importantly, as market participants would expect.

We are continuing to monitor market prices, capital flows, liquidity, and availability of credit in our efforts to assess the functionality and resilience of our capital market. We have been closely engaged with our fellow authorities and market participants in this regard and have provided targeted relief and guidance where appropriate.

We have also been assisting issuers in fulfilling their obligations to provide materially accurate and complete disclosures. And I have urged both corporate and municipal issuers to provide investors with as much information as practicable regarding their current and anticipated financial and operating status.

In addition, we have maintained our strong enforcement and investor protection efforts, especially in the area of COVID-related fraud and misconduct. For example, the Commission has issued over 30 trading suspensions and brought a number of enforcement actions alleging fraud based on COVID-related claims.

Finally, while the agency is engaging in numerous COVID-19 initiatives, we have also continued our traditional, mission-oriented agency functions, including rulemaking, investor outreach, and others.

Thank you again for the opportunity to testify about the work of the women and men of the Commission, and I look forward to your questions.

[The prepared statement of Chairman Clayton can be found on page 52 of the appendix.]

Chairman SHERMAN. Thank you.

We do have a minute available for the Chair of the Full Committee, but I am told—and this does surprise me—that she would prefer that I not yield her a minute.

Mr. HUIZENGA. Mr. Chairman?

Chairman SHERMAN. She is nodding, and—

Mr. HUIZENGA. Mr. Chairman, a point of inquiry?

Chairman SHERMAN. Yes?

Mr. HUIZENGA. My understanding is that the second vote has just been called. Can you lay out for the Members and for the witness your intention of how we are going to be—

Chairman SHERMAN. It is our intention to keep this hearing going, that Members will leave when their appropriate time is to vote. The Chair will leave, and I know that a number of my colleagues are here with names that are different parts of the alphabet, and so we will just keep going. But I realize that there will be a vote, maybe two, that will interrupt our proceeding.

Mr. HUIZENGA. Thank you for the clarification.

Chairman SHERMAN. Thank you. I now recognize myself for 5 minutes for questions.

Small businesses, Mr. Chairman, are very important. You just adopted probably the most popular program we are involved in, the Paycheck Protection Program (PPP), that is going to cost the Federal Government half-a-trillion dollars—well worth it. But it is important that we do everything possible so that small businesses can get capital in ways that don't cost the Federal Government money.

As you know, I remain concerned about the inclusion of business development companies (BDCs) in the SEC's Acquired Fund Fees and Expenses (AFFE) rule, and that the rule has had the unintended effect of BDCs being excluded from many major indexes. This has harmed their ability to raise capital and harmed their ability to fund small businesses.

Mr. Stivers and I have introduced legislation to fix this, and I know you are working to address it as well in the proposed Fund of Funds Rule. Are you confident that the SEC will solve this problem in such a way that BDCs will be included in these indexes?

Mr. CLAYTON. Index inclusion is not something that we can mandate, but I am confident that the women and men in our Investment Management Division are aware of this issue. We have been looking at that treatment.

And et me just say this: In fee disclosure, comprehensive improvement is appropriate. And if you look at our Regulatory Flexibility Agenda, we have both Fund of Funds and Investor Experience on that agenda. I intend to finish those rulemakings and proposals before the end of the fiscal year, and I expect that AFFE modernization, I will call it, will be addressed therein.

Chairman SHERMAN. You can't mandate inclusion in indexes, but you can create a rule that you know will have a certain effect on inclusion in indexes. I think small businesses are perhaps even more important to our economy than the Real Estate Investment Trusts (REITS) that already enjoy a rule that includes them.

The second question is about electronic delivery. I would like to hear from you about your next steps in evaluating electronic delivery of investor documents. Is the SEC looking at expanding electronic delivery for documents beyond the shareholder reports?

And as my colleagues have heard me say, if you mail it to me, I will lose it. If you email it to me, then, if some witness in this room is particularly boring, I can look at it on my iPad while I am in this room, but much more likely, because we only have interesting witnesses here, when I have a spare minute somewhere, I can find it by searching for emails from that company.

So, where are we on electronic delivery?

Mr. CLAYTON. My view on this has been further shaped by the work we have done in this COVID environment. It is clear that we live in an electronic communication world. Let me say that I am of the view that anyone who wants paper, should be able to get paper, but what this period has shown us is the importance of electronic delivery and the effectiveness of electronic delivery.

Chairman SHERMAN. Okay.

I now want to address the fact that companies based in China and I think also Belgium are being traded on our stock exchanges but the investors don't get the protection of the Public Company Accounting Oversight Board (PCAOB) auditing their audit.

Senators Kennedy and Van Hollen in the Senate, and myself and Mr. Gonzalez here in the House, have put forward legislation. I hope that we derive legislation that achieves an important goal, and that is: If the audit is only 20 percent, 30 percent not subject to PCAOB, that is allowed, but when you start having an audit that is more than that, you are asking people to make investments without that protection. And if you are going to invest in—this is the Investor Protection Subcommittee. So, I look forward to working with you to make sure those who invest in American stock exchanges are protected.

And I would also hope that, in evaluating whether to impose the requirement, in measuring what portion of the audit is unavailable to the PCAOB, that you would not look at audit hours. Because I want to make sure that there is no reason to change the numerator, change the denominator by having auditors do more or less. We want more auditing, and then we want the auditors being audited.

So, I look forward to working with you on that.

And I will now recognize the ranking member of the subcommittee, the gentleman from Michigan, Mr. Huizenga, for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman.

And it seems we may have swapped notes and questions here. My first two questions were exactly about the digitization efforts and assessing the impacts on business continuity plans and making permanent changes to investor preferences.

I think you answered that with, "if you want paper, you should be able to get paper."

To expand a little bit on where the Chair was going on the PCAOB, first of all, would it make sense to make clear that the SEC has full rulemaking authority under the bill to ensure that multinational corporations doing a small amount of business in an uninspectable jurisdiction are not intentionally caught up in the bill?

Mr. CLAYTON. So, the question is, what scope of authority would we have in writing the regulations to implement this bill?

I think, as the bill stands, we believe we have the authority to do it. Of course, the more intent you express, the better. But as it stands, we believe we could implement it. But if you have further nuances, further direction, we would, of course, welcome that.

Mr. HUIZENGA. Yes. I just really wanted to find out whether you felt that you had the proper tools to be able to move forward on that, so I am glad to hear that.

As we see small, privately-held businesses struggle to stay afloat during these unprecedented times, some will be looking to sell their business or be forced to close their doors altogether. As you know, I have a bill, H.R. 609, which would allow these small businesses the opportunity to be sold to the next generation of entrepreneurs while also protecting good-paying jobs. I hope you will join me in supporting this, and I believe we need to pass this bill to help these struggling small-business owners.

Are there some things that we can do to make sure that those small, privately-held businesses aren't caught up and treated like a large, publicly-traded company?

Mr. CLAYTON. Yes. We have an office, thanks to Congress, the Office of the Advocate for Small Business Capital Formation. And I am so happy with their work they have been doing, because their job is to affirmatively recognize that small businesses are vastly different—in their capital needs, in their operations—from our public companies.

Just in response to COVID, we have adjusted the crowdfunding rules, now, let me just say, all without any degradation in investor protection, but to serve smaller businesses and to understand that the rules for them raising capital and access to capital should be different from public company rules, and they shouldn't require hundreds of lawyer hours to get through.

Mr. HUIZENGA. And I believe that sections within the Bar have supported this in the past. We have seen a number of efforts. I have passed this bill through the House unanimously, and then it became partisan somehow. But, nonetheless, I am hoping that we can count on your support and help in exploring that.

You have also testified before this and other committees several times during your tenure as SEC Chair. Members of both parties on both sides of the Capitol have raised the issue of the victims of the Stanford Ponzi scheme at nearly all of these hearings.

You have indicated a willingness to be helpful to these victims, but over 21,000 of them, including several of my constituents, have been waiting over 11 years. Can you give them an update on the status of the Commission's efforts to help them get their money back?

Mr. CLAYTON. Let me say this: When you look at the status of the Stanford victims, you can't reach any conclusion other than there was a failure in the system. Everything that went on there had the veneer of legitimacy. Yet, at the end of the day, they haven't gotten much money.

And we have dedicated substantial resources to try and help them get more money back. They are never going to be anywhere close to whole. In fact, they are never going to be anywhere close to anything close to whole, anything satisfactory. But we are working on it. We are looking at the remaining claims that they have and, consistent with our authority and our independence as an agency, trying to help them as much as possible.

Mr. HUIZENGA. In my last 45 seconds, I want you to talk about the trajectory of our overall economy, the health of our markets, where we are going, and your optimism on that, or pessimism.

Mr. CLAYTON. Here is where we are: We have been able to stabilize our capital markets and the flow of credit in our economy, thanks to the great work of the Treasury and the Federal Reserve, in conjunction with this body.

We are still in a period of uncertainty. From my perspective, we are going to go into second-quarter earnings, and we are going to find out a lot about how companies are operating. Hopefully, what we will see is companies adjusting and continuing to increase their ability to operate.

You are going to see that from public companies. To the extent that filters down to private companies, that is terrific, but we do need to do what we can to keep the economy going, as we learn more about how to deal with the virus operationally.

That is as quick an answer as I can give you. We have done well, but we have work to do.

Mr. HUIZENGA. Thank you.

I yield back. And, Mr. Chairman, I am going to have to excuse myself, because I am about 5 minutes late for my vote section. So I will turn it over—

Chairman SHERMAN. I understand.

Mr. HUIZENGA. —to the ranking member of the Full Committee.

Chairman SHERMAN. And "S" will come up in the alphabet soon, so it will be my turn to vote.

I want to assure the witness that I am getting notes from staff as to how to conduct the hearing, but I am not using this iPad to review the investor disclosure materials from any of my portfolio companies.

Mr. CLAYTON. If we had addressed the AFFE, you would, though, right?

Chairman SHERMAN. I promise you, not while you are here.

I now recognize the distinguished Chair of the Full Committee, Chairwoman Waters.

Chairwoman WATERS. Thank you very much. I appreciate the opportunity to be here with you today at this hearing.

Chairman Clayton, in the middle of the night last Friday, Geoffrey Berman, the United States Attorney for the Southern District of New York, was forced out of his position by President Trump and Attorney General Barr.

The Attorney General subsequently announced that President Trump intended to nominate you as Mr. Berman's replacement. Your actions appear to be a continuation of President Trump's efforts to squash any attempts to hold him and his enablers accountable.

As you know, the Southern District of New York has been instrumental in conducting independent investigations into President Trump's associates and the Trump organization and is currently investigating Deutsche Bank, an institution with long and substantial financial ties to President Trump.

In light of these past actions, I am deeply concerned that while your nomination to this important post is pending, President Trump and Attorney General Barr may try to interfere with your ability to independently and effectively oversee the Securities and Exchange Commission in its mission of serving as Wall Street's cop on the beat during a global health pandemic that has caused one of the worst financial crises of our lifetime.

Do you plan to continue serving as Chair of the SEC while you await your confirmation?

Mr. CLAYTON. Chairwoman Waters, as I mentioned in my opening statement, I don't think that matter requires my attention at this time—

Chairwoman WATERS. I'm sorry. Would you speak up, please?

Mr. CLAYTON. I'm sorry. I don't think that matter requires my attention at this time, and I expect to continue to devote my full attention to the Commission.

Chairwoman WATERS. So, you will continue to serve as Chair of the SEC while you await the confirmation? You will not step down? You will not step aside? They will not have someone take your place in any shape, form, or fashion, as far as you know?

Mr. CLAYTON. Let me just say, from where I sit right now, this is not the time to decide about the nomination. I am here as the Chairman of the SEC. As I look at it, there is no need for me to pay any attention to the nomination at this time. I am fully committed to being the Chairman of the SEC.

Chairwoman WATERS. And, of course, that would not be your decision, and I am not asking you if you are making that decision. I am basically wanting to know, has anybody else said to you that you would not be serving as Chair while you await confirmation? Has anyone said that to you? Did the President? Did Attorney General Barr say that to you? Anybody?

Mr. CLAYTON. No.

And, look, I have checked this matter with our Ethics Office and the like. I intend to continue to serve as Chairman of the SEC and devote my full attention to my duties as Chairman of the SEC.

Chairwoman WATERS. Thank you.

Will you commit today to recuse yourself from any and all matters before the SEC that directly or indirectly involve President Trump or which may create the appearance that your actions serve as a special favor to President Trump in order to obtain a position that President Trump and Attorney General Barr have highly politicized?

Mr. CLAYTON. I am going to continue to do what I have always done at the SEC, which is to pursue all matters with independence, and to consult with Ethics on any issues that would give the appearance of not having independence. But I will continue to operate as I have been.

Chairwoman WATERS. Thank you. So, that is a, "yes." Let the record show that you have answered in the affirmative.

Let's see if we have time here for one more question.

Chairman Clayton, at the onset of the crisis, I called on you and other financial regulators to immediately halt the adoption of all rulemakings not directly related to addressing the unprecedented health and financial crisis caused by the COVID-19 pandemic.

I made it clear that 100 percent of the SEC's resources should be dedicated to protecting investors in U.S. capital markets during the pandemic. I was also clear that it would be unacceptable for the SEC to use this crisis to justify regulatory rollbacks of important investor-protection regulation.

Yet, as I outlined in my letter to you this week, I continue to see the SEC, under your leadership, engage in deregulatory rulemaking that expands private markets that the State securities regulators have testified are rife with fraud. This proposal would limit the amount and reliability of information investors rely on, at a time when markets are experiencing the highest levels of volatility since the 2008 financial crisis.

Another proposal would prevent many small shareholders from seeking to reform and modernize the companies they own, including by making it harder to propose increasing board diversity, paying workers a living wage, taking seriously climate change, or making changes to adapt to the post-pandemic world.

So, have you paid attention to what we are concerned about, and the relationship to not using this as a time to do deregulation?

Mr. CLAYTON. What I can say is, our regulatory agenda—

Mr. MCHENRY. The time—

Mr. CLAYTON. —has been public. We are continuing to pursue our regulatory agenda. We are doing so in a very open way. We are continuing to take comments and engage with people. And in those areas where investor protection, my aim has been—

Mr. CASTEN. [presiding]. The time has expired, unfortunately.

Are you okay letting him finish?

Mr. CLAYTON. Thank you.

Chairwoman WATERS. Thank you. We will follow up.

Mr. CLAYTON. Thank you.

Mr. CASTEN. I now recognize the ranking member of the Full Committee, Mr. McHenry, for 5 minutes.

Mr. MCHENRY. Chairman Clayton, as I have written to you about, harmonizing the choppiness of regulations within the Securities and Exchange Commission, I think is something that has been needed for quite a long period of time. But I wrote to you specifically about regulation crowdfunding. This is an issue that I have worked on for a decade.

Especially now, I think we need to help small businesses. And we need to help small businesses in a variety of ways, not just with lending, but the opportunity to raise other forms of debt, as well as through capital raises for equity as well.

I wrote to you about this, specifically about special-purpose vehicles and increasing the offering limit. I just wanted to see if you would elaborate on the comments you have received and when it looks like you will finalize the rulemaking?

Mr. CLAYTON. I don't have a specific timeframe for that, but it is on our agenda to finish sometime around the end of the fiscal year. I intend to stick to our agenda.

What we are trying to do, if you don't mind me taking a few minutes, is—let's just say you are a small or medium-sized company and you are looking to raise capital. You have to weave your way through a patchwork of six or seven different types of exemptions, including regulation crowdfunding. And you need a Ph.D. in securities law to do it. What we want to do is basically streamline that process without in any way degrading investor protection, and, in fact, hopefully increasing investor protection. Let's get rid of all that cost while maintaining—

Mr. MCHENRY. So, in some respects, like with regulation crowdfunding, we have a more onerous—capital raised for $50,000 than we do for $50 million. And that doesn't make sense in terms of a cost burden for the protection of the investor, the clarity of information for the investor.

So, rightsizing those things so that there is a gradual change in regulatory cost and oversight based off of the raise, instead of having arbitrary break points to smooth those things out, is that the focus of your work?

Mr. CLAYTON. Yes. That is a fair summary.

Mr. MCHENRY. What are the benefits? What do you think we will get as a benefit if this is done successfully?

Mr. CLAYTON. A hopeful benefit—because, right now, our most acute problem is, for companies getting started, raising $200,000, $300,000, $400,000, $500,000, generally, that is achievable through people, friends and family, the like. Trying to take that company from that size up to a $25 million company is extremely difficult. Once you get to $25 million, you have institutional investors who are sophisticated. You bring them in and.

It is in that gap—pick your number, $500,000, $1 million, $2 million, up to $50 million—where there is a tremendous amount of choppiness, and access to capital could be better, with investor protection. We could limit investment size; we can do a bunch of things. But it is too choppy where it is now.

Mr. MCHENRY. Okay. And I commend the work that you have focused on here. It has been due for decades at the SEC. And I think that was how—some of the poor implementation of the JOBS Act that you can remedy and make clear the intention of Congress here.

I want to highlight, also, on Environmental, Social, and Governance (ESG), we had a recent panel before this committee. The head of sustainability at BlackRock said that there was, "an overabundance of ESG data, and the strong majority of the ESG data is not connected to materiality, which is a fundamental foundation of our disclosure framework.

So, given the vast amounts of data and questionable utility for at least some, if not most, companies, do you think it would be appropriate for the Commission to dictate a single ESG scoring system for every public company using that data?

Mr. CLAYTON. That is coming at it in one way. Coming at it in a different way, I have been very clear that I think a single ESG metric doesn't make a lot of sense.

When you take qualitative metrics that have a degree of subjectivity and then personal preference—so just one of those has a fair amount of ambiguity in it, and you combine them together to come up with one score, I kind of—I love that the economist Ken Arrow won the Nobel Prize for showing that, when you try to rank like that, it doesn't work out very well.

Mr. MCHENRY. Okay.

So, likewise, with the coronavirus, do you think there is an appropriate one-size-fits-all disclosure requirement for risks related to the coronavirus?

Mr. CLAYTON. What we are seeing around—and I have to commend our staff, because we have gotten out there and tried to give companies as much guidance as we can on how to disclose around the effects of the coronavirus and our response.

And it is vastly different from company to company. So, no. Some companies have benefited in some ways. Some companies are completely shut down. Some companies have liquidity problems; others don't. Some have operational issues.

Our principles-based system has proven itself through this response. And, the second-quarter earnings season is going to be the same way.

Mr. MCHENRY. Thank you. Thank you for your statement. And thank you for your work.

I yield back.

Mr. CASTEN. I now recognize the gentlelady from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. Thank you.

And thank you for being here today, Mr. Clayton.

I want to address the issue that is on everyone's mind, the scandal in the U.S. Attorney's Office in the Southern District of New York, which is in my home district. The office has several open investigations involving President Trump, his company, and his close associates, including Rudy Giuliani.

There have been press reports that President Trump was very unhappy about the Southern District's decision to investigate his friends. And then, on Friday night, Attorney General Barr released a statement falsely claiming that the U.S. Attorney in the Southern District, Geoffrey Berman, had stepped down, and announcing that the President intended to nominate you as his replacement.

Of course, we now know that the Attorney General was lying. Mr. Berman had not agreed to step down, and when he refused to step down, the President fired him.

This episode was extremely troubling to many of us and suggests that the President fired a U.S. Attorney for refusing to follow his directions on criminal prosecutions. That would be a blatant abuse of power and should be unacceptable to everyone.

Now, Chairman Clayton, you and I have a really very productive relationship, even though we don't always agree, but I have to ask you some questions about this episode and your involvement.

When did you first discuss the Southern District job with the President or the Trump Administration, and with whom did you discuss it? Attorney General Barr?

Mr. CLAYTON. Look, I am here as the Chairman of the SEC to discuss the work of the SEC. What I can say is that, as I said in my opening statement, I need to go back to New York. We are both from New York, and—

Mrs. MALONEY. Okay. But I was just asking for a timeline. When did you discuss it? Just give me the approximate date, the timeline.

Mr. CLAYTON. What I want to say is, this is something I have been talking about for a while, consulting with people as to whether this would make sense for me to continue in public service. This was first raised to the President and the Attorney General last weekend as something that I had wanted to do, and they first became aware of it last weekend.

Mrs. MALONEY. Okay. Thank you.

And did you know that Mr. Berman did not want to leave his job in the Southern District when you agreed to accept the nomination? In other words, did you know he was going to be fired to make room for you instead for the job?

Mr. CLAYTON. I am not going to get into that here.

Mrs. MALONEY. Okay.

If you are eventually confirmed by the Senate for this job, would you commit to recusing yourself from all of that office's current investigations into President Trump and his associates?

Mr. CLAYTON. Here is what I am going to say. That is a process that is way down the road. In my current position and in any position I take, I commit to doing it independently, without fear or favor, and in the pursuit of justice. And there is nothing—

Mrs. MALONEY. But that is—excuse me back. I'm sorry, that is not what I was asking. I was just asking for a commitment to recuse yourself, should you be appointed, from the investigation involving the President or any of his associates.

Because I have to say, the circumstances of Mr. Berman's firing were very suspicious and raise a lot of questions about whether the President is interfering in ongoing criminal investigations.

I personally think the American public deserves a clear answer on whether you will recuse yourself from these very sensitive investigations into the President and his associates. So I am asking a very simple question: Will you commit right here to recusing yourself from these investigations?

Mr. CLAYTON. That position and that process is something that is separate and doesn't need my attention today. What I will commit to do, and what I commit to do in my current job, is to approach the job with independence and to follow all ethical rules.

Mrs. MALONEY. I understand that you don't want to talk about this right now, but I think it is important that the American people, right now, know these answers. Because if you are not going to be independent—and the way to be independent is to recuse yourself—then we need to know so that someone else can be nominated. We need independence.

Mr. CLAYTON. Understood. And I commit to independence.

Mr. CASTEN. I now recognize the gentlelady from Missouri, Mrs. Wagner, for 5 minutes.

Mrs. WAGNER. I thank the Chair.

And I thank you for joining us today in person, Chairman Clayton, to discuss U.S. capital markets during this pandemic.

And I just want to say, for the record, I have worked very closely with you and your office and found you to be a person of incredible integrity and character and the highest of ethics. So I want to thank you for that, and I am sure that you will continue to comport yourself in such a way. I have great confidence in you.

Chairman Clayton, despite the challenges of the coronavirus, I am pleased to see that the Commission is hard at work looking to improve our markets.

Can you please describe recent proposed changes to your equity market structure and where you think improvements will be most valuable for the investing public, specifically Main Street investors that I have fought for so passionately for the past 8 years in Congress?

Mr. CLAYTON. Thank you.

Our equity market structure has become incredibly complex. Just to level-set everyone, virtually all trading—I can almost emphatically say, all trading is electronic, it is done in nanoseconds, and it is complex.

Our job at the SEC is to make sure that what you pay for trading—and it ultimately filters down to our long-term investors—is fair and reasonable. And we are looking at both infrastructure and governance of data plans and the way data is distributed to those who trade in our markets to try and make sure that aspect drives fair and reasonable pricing.

Mrs. WAGNER. Thank you.

Chairman Clayton, I am also worried about the risks of fraud stemming from the coronavirus. We saw during the 2008 financial crisis a rise in investment scams that take advantage of the extreme volatility in the stock market that we have seen. And I am deeply concerned about the seniors in my district, those who are saving for their retirement security. I am concerned about these scammers who are out there.

Can you describe what the Commission is seeing in terms of coronavirus-related fraud and scams and what the Commission is doing in its examinations and enforcement efforts to reduce these kinds of fraud?

Mr. CLAYTON. Unfortunately, we are seeing coronavirus-related fraud. We are seeing people tout products that they say they have, testing that they say they have, and then trying to pump up the value of their stock. Or in private placements, we are seeing some of that.

And our enforcement staff is being extremely proactive in looking at these claims and, if there are substantial indicia of fraud or misconduct, bringing trading suspensions and eventually actions.

What I can say to investors is, deal with professionals. Let's deal with professionals—broker-dealers, investment advisors. If you are at all doubtful about any of these—

Mrs. WAGNER. Known entities.

Mr. CLAYTON. Known entities.

Mrs. WAGNER. Those that you have worked with before and such. Because we are seeing it quite on the uprise. We certainly saw it in 2008. And it is something of deep concern to me, to the retail investor, and especially to our most vulnerable seniors who could lose everything that they have. So, it is of great concern to me.

I am encouraged, like everyone, to see that the Commission remains committed to its regulatory agenda during the pandemic. The SEC, under your leadership, has made great progress on a number of proposals that will remove unnecessary regulatory burdens on businesses and streamline the flow of capital—capital that we need so desperately right now to stimulate economic recovery.

I know you have been giving us some updates on what you have in the queue here. I was very pleased to see that the Volcker Rule was finalized today.

Any other brief update on the progress of the Commission's efforts, especially on things like to harmonize the exempt securities offering framework, and the proposal to modernize the framework for fund valuation practices and such? I think that comment period ends on July 21st or thereabouts, so any kind of a quick update would be great.

Mr. CLAYTON. I am optimistic that we will be able to conclude, if not all items, virtually all items on our regulatory agenda, including what I want to say is the harmonization of that exempt offering framework and bringing transparency to a number of places where transparency is needed.

And I am excited about the fact that the women and men of the SEC, through a telework posture, responding to all of these events, have been able to continue with our defined agenda and do so in an incredibly professional way. I just can't say enough good things about them.

Mrs. WAGNER. Great. Thank you very much.

And I yield back to the Chair.

Chairman SHERMAN. Mr. Himes is now recognized for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman.

Chairman Clayton, thank you for being here.

I am sorry that you are caught up in this series of events which have raised questions that Mrs. Maloney articulated. I am particularly sorry that this has had the effect of calling into question, either explicitly or implicitly, your integrity, your independence, and your reputation.

We have known each other for some 3 decades and have worked on a lot of things together, and if I were a Senator contemplating your confirmation, I would do my job and look at your qualifications, your history, and your philosophies, but I would absolutely have no questions whatsoever about your reputation, your independence, or your integrity. But I am not a Senator, for better or for worse.

Speaking of integrity, Chairman Clayton, I was delighted to see your statement of June 22, 2020: The SEC and the Justice Department's Antitrust Division sign an historic memorandum of understanding (MOU), the purpose of which, apparently, is to enhance competition in the securities industry.

My suspicion is that this MOU was signed because both entities had some areas of investigation in mind. And I wonder if you might share with us areas that this new joint venture or cooperative enterprise might be looking at.

Mr. CLAYTON. Thank you very much for your comments.

And what I want to do is—"investigation" may be a loaded word. I don't want to imply that we are investigating anybody together. But what we have been doing—and I greatly appreciate our friends at the Antitrust Division—is we have been working together on a number of items.

They have people with great expertise. We oversee complex markets. They are able to help us with some of these issues, and we are able to help them. We have deep expertise in how our markets operate, and we have been sharing that with them.

The MOU formalizes that relationship. You know, no secret, I expect to be completed with this job at the end of the term, and I think Mr. Delrahim is of a similar—and we want to formalize that really powerful relationship.

Mr. HIMES. Just because I have very limited time, to date, no particular areas of possible uncompetitive behavior have been contemplated?

Mr. CLAYTON. We don't talk about pending investigations. But I don't want people to think that this is somehow anything more than continuing the cooperation that we have had across our respective agencies and divisions.

Mr. HIMES. I think you know what I am going to say next, because we have had this conversation a couple of times. Just for kicks, I printed out again the pricing for initial public offerings in the middle market. This blue bar you see here shows almost perfect clustering at 7 percent as gross spread for IPOs in the middle market. And we have talked about this a lot before.

I seek unanimous consent, Mr. Chairman, to make this a part of the record.

Chairman SHERMAN. Without objection, it is so ordered.

Mr. HIMES. And, again, it is just a blue bar showing that middle-market IPOs are priced at 7 percent.

The price of a flight from New York to L.A. moves around a lot. The price of a gallon of gas, or the price of an apartment for a month in D.C., moves around a lot, because it is a competitive market. I don't know if 7 percent is too much or too little; I am just blown away by the fact that it never varies from 7 percent.

Is that perhaps an area that this new cooperation with the Justice Department might take a look at?

Mr. CLAYTON. Let me say this: That is the kind of thing where our cooperation, I think, would lead to better analysis.

Mr. HIMES. Okay. I appreciate that. And I will probably not let that particular horse die any time soon.

But I do want to ask you about one other thing. In a February 14, 2020, statement on adding more stock price information to market data feeds, you said, "Both the content and the technologies used to collect, consolidate, and disseminate market data have lagged meaningfully behind proprietary data products and systems offered by the exchanges."

The general public watching this doesn't know what that means, I suspect. So correct me if I'm wrong, but what you meant there was that exchanges sell much more robust information about the nature of trading markets than is available to the public who does not purchase that information. Is that fair to say?

Mr. CLAYTON. That is a fair way to say it.

Mr. HIMES. Okay.

So, apart from the fact that one is illegal and the other is legal, apparently, what is the difference between my paying a corporate insider for more robust, non-public information about a corporation, and a trading entity paying an exchange for non-public information?

Mr. CLAYTON. Our law requires, for trading and whatnot, for us to look at what is being done, and if it is fair and reasonable. And one of the questions that we have is—I am going to use my hands to describe what you did.

Here is the publicly available data. And we started here with the robustness of privately available data. What we have is an increase like this. And that gap we have to look at and decide whether it continues to be fair to trade under those circumstances and whether people can comply with their obligations.

Mr. HIMES. So there is some gap at which you would judge it to be unfair between that which you pay for and that which you get publicly?

Mr. CLAYTON. Yes. That is a very good question.

Chairman SHERMAN. Your time is up.

Mr. HIMES. Thank you, Mr. Chairman.

Chairman SHERMAN. Mr. Stivers is now recognized for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman. I appreciate you holding this hearing.

Chairman Clayton, thanks for being here. And good luck in your future endeavors, but I am excited about what you have been doing at the Securities and Exchange Commission. And I want to say thank you for the work you have done to make rules that make sense and that give investors more information. Thank you so much.

I do want to follow up on something the chairman brought up. Chairman Sherman talked about the Acquired Fund Fees and Expenses (AFFE) Rule. Obviously, it was built for mutual funds, not companies that have operating expenses. And so, those expenses for business development companies make it look like they are eating things up with fees, but they are really operating expenses. So, when you list equities, you don't have them talk about their operating expenses. It is the expenses that deal with their investors and the investors' fees.

Mr. Sherman and I have a bill, and we will pass it if we have to, but I believe you can fix this. I know you can fix it. You are already working on it. And I hope you fix it and we don't have to pass our bill. But I am not going to back down from passing our bill, because I think it is really important.

This ultimately impacts middle-market and small-business companies in my district and all around our country, because they get less access to capital as a result of a rule that was built for mutual funds and is now applied to a company that essentially has operating expenses and those have to be disclosed and make it look like there are too many fees.

So, please take care of it. But if you don't, don't worry, we will.

Mr. CLAYTON. Okay.

Mr. STIVERS. That was the first thing I wanted to bring up. And the other thing that I wanted to chat a little bit about is the Nationally Recognized Statistical Rating Organizations (NRSROs).

A number of our committee members have expressed some concern that the Fed's emergency facility arbitrarily shows winners and losers in NRSROs. That is a real concern to me. I think we need to make sure that everybody has access to these new facilities that are coming up.

You are the primary regulator. Has the SEC been consulted by the Federal Reserve on the subject of rating agencies?

And if not, have you offered any information that can help them understand how they can decide a way to choose rating agencies that is not based on some arbitrary decision or some decision that doesn't actually look at the health and quality of those NRSROs?

Mr. CLAYTON. The short answer is, yes, we are in dialogue with the Federal Reserve across the programs on the use of rating agencies and providing them the data that we have to help them make the judgments as to which rating agencies are appropriate for which programs.

Mr. STIVERS. Great. Thank you so much.

Again, during your time as Chairman, you have championed issues that protect investors while giving them greater access to choice. My colleague from Minnesota, Dean Phillips, and I have a bill that we have introduced that would direct the SEC to do more tailoring on your rules for registered index-linked annuities.

Those products give investors access to upside while giving them capital protection. But a lot of the forms they have to fill out are built for equity companies that have a lot of information that is not necessarily relevant and is just hard for them to navigate.

So, again, this is something that we don't have to pass a bill on; you could actually fix this yourself. And I would just highlight it for your attention, and I hope you will pay attention and fix that yourself.

Mr. CLAYTON. Thank you.

Mr. STIVERS. Thank you.

I want to again thank you for your great work at the Securities and Exchange Commission. You have unfinished business. We know you are focused on that and going to stay focused on that through the end of the year. Good luck in whatever the future holds for you, but thank you for what you are doing for investors every day.

Mr. Chairman, I yield back.

Mr. CLAYTON. Thank you very much.

Chairman SHERMAN. There seems to be bipartisan support for that position.

I now recognize Mr. Foster for 5 minutes.

Mr. FOSTER. Thank you, Mr. Chairman.

And thank you, Chair Clayton, for being here.

I really appreciate the work that you and your staff have done in being proactive about looking out for scams and fraud related to COVID. It is important, and it is timely.

Equally important, and maybe more important in terms of market capitalization, are the possibilities of share-price manipulation among pharmaceutical firms as all of these ongoing clinical trials report out. You have already seen situations where results have been released, resulting in massive swings in share prices, and scientists questioning the timing, from a scientific point of view, of the release of that information.

Are you doing anything in that way, to look at possible share-price manipulation?

Mr. CLAYTON. Let me try and do this in the most appropriate way. We don't talk about pending investigations. We just don't do it.

Do we look for patterns of activity, generally, that would create suspicion in anybody's mind—timing of announcements, timing of buys, timing of sales, that type of thing? Yes, we have a group that does that.

Mr. FOSTER. Have you added extra capacity and moved your eyes directly towards COVID-related pharmaceuticals?

Mr. CLAYTON. I am sorry that I am being more elliptical than I should be.

And we do that in the context of the current day. And we are doing it in the context of the current day. Just as we are looking at COVID-related fraud, we are looking at anything that would be market-moving in the context of the kinds of pharmaceuticals, and other things that you are talking about.

Let me be clear about this. Right now, we have encouraged companies to get out there with information as quickly and transparently as possible. Because, in uncertain times, non-public information becomes incredibly valuable and is a place where there can be great misconduct. We want companies to be as transparent as possible and, when they are not disclosing information, to keep it as confidential as possible.

Mr. FOSTER. Yes. That obviously makes them a huge target for things like cyber espionage and so on.

Mr. CLAYTON. Yes.

Mr. FOSTER. So, I just urge you to really keep your eyes focused on that sector. Because there are going to be very important clinical trials reporting out over the coming months, and the eyes of the world are going to be on these, and lots of investors are going to be involved.

Now, I appreciate all of the efforts you have made to continually be effective in your job at the SEC as you are being considered to lead the Southern District of New York office. I appreciate that. And I also appreciate that your discussions that you must have had with Attorney General Barr or the President or anyone in that command chain really should remain confidential.

But separate from that, did you have any discussions with anyone representing or speaking for the Trump family organization, President Trump's private lawyers, or anyone outside the command chain that goes through Attorney General Barr?

Mr. CLAYTON. Look, I don't want to go down the road of getting into all of these things, but I have not talked to anybody about any pending matters—

Mr. FOSTER. No, I am talking about considerations involving your appointment. Were they confined to the appropriate command line that goes from the President to Attorney General Barr and that command line, or did you have communications outside of the command chain, which, I think, shouldn't be subject to the same sort of confidentiality?

Mr. CLAYTON. Let me say it this way. I don't want to get into what—I am not going to talk about it. There is a time—but I am completely comfortable that anybody I talked to about this was appropriate to talk to.

Mr. FOSTER. Were you contacted by people that you turned away because you did not feel comfortable?

Mr. CLAYTON. I am just going to leave it at that.

Mr. FOSTER. Okay.

Consolidated audit trail: that was on your to-do list when you came into the job.

How do you feel about the progress you have made, particularly relating to what will, I think, ultimately be the toughest thing, which is getting international agreement to have personal identifiers for the participants for trades in international venues? How do you see that going?

Mr. CLAYTON. I think we have made substantial progress. Let me say that we started from a bad spot. We started from a bad spot in terms of security and in terms of architecture, and we have made substantial progress. I believe we will have a completed consolidated audit trail that functions as intended. It will be late. It is already late. But I think we are going to get there.

Mr. FOSTER. But that will require international agreements, to get access to the actual identities of the participants at foreign venues. And this has already struck me as the toughest thing. It is probably not made easier because of an Administration that isn't enthusiastic about international agreements. What sort of progress do you see has been made there?

Mr. CLAYTON. We are making progress internationally on that type of—LEI or the like.

Mr. FOSTER. Thank you. And I will be following up.

Mr. CLAYTON. Please.

Mr. FOSTER. I yield back.

Chairman SHERMAN. Thank you.

Mr. Hill is now recognized for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman. And I appreciate the opportunity to have Chairman Clayton with us today.

And I want to thank you, Chairman Clayton, for the Commission's leadership and your staff's leadership through the pandemic crisis of March, where you kept your head about you, as your fellow Commissioners did, when all were losing theirs around you—I think there is a poem in there somewhere—but specifically in keeping our markets open for the benefit of our constituents, that they had access to knowing the value of their account and could consult with their investment professionals through that period.

And, again, as I always do, I commend the work of the Fed and the Treasury for their quick work in liquidity. So, thank you for being a part of a team that got our capital markets functioning again for the benefit of companies who employ millions and millions of Americans.

And, also, thank you for your support, as Chair, for entrepreneurship and capital formation and your putting strong attention on that, as well as the need to assess things that are important to the fintech arena.

We have a new Securities Commissioner in Arkansas as of last month, Eric Munson. And we look forward to you meeting Eric in his new capacity and look forward to hopefully introducing you personally to Eric as he takes up his new responsibilities at the Arkansas Securities Department.

I want to take a minute today and talk about one of Mr. Sherman's bills that is not introduced yet, I don't think, Mr. Chairman. It is a bill that you mentioned on our call the other day on potentially having the primary corporate facility of the Fed ensure that it is subject to Section 4003 of the CARES Act.

And I took that comment from you—and it is in our Commission report dated June 18th that the Fed and the Treasury confirmed, that any bond purchased in the primary corporate facility is in compliance with the limitations in the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

Chairman SHERMAN. If the gentleman will yield, I have little doubt that everything that is being done is legal—

Mr. HILL. I can't yield to you right now, because I am busy talking to our good SEC Chair, but I will be back in touch later. But, thank you. And if I can help on that, let me know.

Mr. Clayton, I wanted to talk to you about the municipal order that you issued providing exemptive relief to municipal advisors under the rubric that it is good during the pandemic. You know my views on this; I expressed them to you in a long letter in February during the comment period on it.

I don't really believe that this should have been done by exemptive relief. I have expressed that to you. I think if we are going to make changes in the municipal market for our State and local governments, we ought to do that through the Administrative Procedure Act (APA) with the rulemaking.

What led the Commission to do a temporary order rather than following the APA?

Mr. CLAYTON. Let me say this: Whether we have to follow the APA or not, I think we are confident that the way we have done this is appropriate, but it is very narrow. This was something that was contemplated—and it is temporary. And it would be my expectation that if this were done on anything like a permanent basis or in any broader scope, that there would be opportunity for notice and comment.

Mr. HILL. Thank you. I do recognize that you made a significant narrowing of the scope since it was originally proposed, and you attempted to meet some of the questions that came in the comments from the bond dealers and from the Municipal Securities Rulemaking Board (MSRB) itself.

But I see your temporary relief was dated June 16th. And when you look at the municipal securities market, it is functioning quite well due to the work of the Fed and the Treasury. I see no lack of access for State and local governments to reach the market through traditional means. In fact, all of the month of June has seen capital inflows into all of the tax-exempt bond funds.

So, I don't view it as an emergency situation. I view this more as a wolf in COVID sheep clothing, in terms of using the pandemic to justify its rationale.

So if at the end of the temporary order, a municipal advisor must notify the SEC of any direct placements, will the SEC make that public, that information, who does those placements?

Mr. CLAYTON. We are going to get that information. I don't want to commit here to making it public, but I will commit to considering whether it should be made public.

And I would expect that if the activity during this period would be something that would be considered, again, through any kind of open notice and rulemaking if this were going to be extended, expanded, or the like.

I do want to note that it is limited in size and the secondary market distribution is extremely limited.

Mr. HILL. Right. Thank you. I appreciate, again, our dialogue on this.

And I yield back, Mr. Chairman.

Chairman SHERMAN. The next questioner I will recognize is head and shoulders above the average Member of Congress all the time, but today he is 15 feet above us here in the hearing room on the screen, and that is Mr. Meeks. You are recognized for 5 minutes.

Mr. MEEKS. Thank you. I want to thank you, Mr. Chairman, for holding this crucial hearing today.

The interesting thing is that most people actually wish this hearing was a little less important, that the only issues that are stated here were our securities laws and our capital market regulations and the investor-protection bill before this committee. Undoubtedly, these things are crucial to our strength as a nation and our status as the financial capital of the world. But I would be remiss if I did not say that all of these issues are built on something vital and even more important, and that is the rule of law.

Recently, millions of Americans have taken to the streets, shouting, "No justice, no peace." And the core notion here is simple, that no person is above the law, regardless of whether they are wealthy, whether they wear a blue uniform and a badge, or even if they live at 1600 Pennsylvania Avenue. And they want to make sure that there is equity and that the justice system is fair to everyone.

And I know, Mr. Chairman, by the standards of the Administration, you clearly have had a solid run at the SEC, and your tenure has not been littered with corruption or scandals or anything of that nature. In fact, I know you have really worked hard on issues like cryptocurrency scams, and you have taken real steps to protect investors, in my view.

So, I certainly hope that things don't go awry in regards to what you are now being considered for, and that we continue to try to make sure that we have liberty and justice for all and it does not ruin your reputation as you move forward.

I will stop there, and let's go to some policy questions that I think are important for me to ask you, listening to some of your statements earlier in regards to, you are going to be focused continually on your job as the Chairman of the SEC.

My first question is, the SEC whistleblower program that was created by the Dodd-Frank Act has been incredibly successful at uncovering fraud in our financial markets. And your predecessor, Mary Jo White, called the program a game-changer and stated, "It is past time to stop wringing our hands about whistleblowers. They provide an invaluable public service, and they should be supported."

So my question to you, sir, is why have you sought to reform a program that seems to be, and has been proven to be, so effective?

Mr. CLAYTON. I believe—let me make sure I have it correctly—you are talking about our whistleblower pending amendments. And let me say this about our whistleblower program: It has been extremely successful, and I am extremely supportive of it. I think you can see from the recent awards that we have not slowed down, and in fact, we have sped up, the timing for processing awards and getting them out to whistleblowers.

What I am committed to doing is making this program as transparent and as efficient as possible. And I am hoping to move forward to finalize those amendments. And what I will say is, not decreasing but actually increasing the incentives for people to come forward as promptly as practicable.

Mr. MEEKS. Thank you for that. We will be watching and following, because that is tremendous. We have seen whistleblowers recently have their reputations ruined in an attempt, it seems to me, to discourage folks, not necessarily from the SEC but with some of other policies that have taken place, particularly coming out of 1600 Pennsylvania Avenue.

Let me just ask another question in my remaining time. In the last few months, a record number of day traders have become active in the market. And Jim Cramer recently claimed that Warren Buffett is, "overrated" and "washed up," and that he, "used a Scrabble bag to recommend stocks to his many followers."

So my question is, how has the SEC reacted to this phenomenon of day trades? And does it need any additional tools from Congress to address this issue?

Mr. CLAYTON. I don't know that we need additional tools. But I do see—and there is no doubt about this—there has been increased short-term retail participation in our markets, and when I see that, it concerns me. It concerns me that people do not know the risks they are taking, particularly in leveraged products, options, and trading on margin.

And let me just take this opportunity to thank you for the question and to tell all of our retail investors that these are sophisticated products that have risks that may not be apparent, and you should be quite cautious in trading with leverage, trading in options, trading with—I'm sorry. My time has expired.

Chairman SHERMAN. Thank you.

Mr. Davidson from Ohio is now recognized for 5 minutes

Mr. DAVIDSON. I thank the Chair.

And thank you so much for being here, Chairman Clayton. After your appearance before the Full Committee last time, I submitted questions for the record regarding bulk download of data from FINRA's Consolidated Audit Trail (CAT) system. Thank you for your responses to the questions.

And, in your responses, you highlighted the work the SEC has done to limit the types of data collected, as well as the directive for the SEC staff to provide recommendations that will help enhance the Consolidated Audit Trail's cyber and data security. So, thank you for that.

As you know, this, as proposed, would be the largest database to be created and overseen by a regulatory agency, and it contains extremely sensitive information. Every firm that is supplying this data would view it as very proprietary, trade secrets, the keys to the kingdom. The concern is all the more highlighted by the SEC itself suffering a breach of the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) System in 2016.

One of the questions that you posed to staff in your directive was the issue of bulk data downloads. And as I understand it, the more than 20 self-regulatory organizations (SROs) and the SEC would be able to download bulk data from the CAT.

What particular concerns do you have with this data being distributed across SROs, that led you to pose these questions to the SEC staff? And what do you think should be done to ensure the SEC and FINRA have the proper internal risk controls to protect that data held in the CAT as well as held by them once it is downloaded? And are you evaluating those controls?

Mr. CLAYTON. The short answer is, yes, we are evaluating those controls. It is the types of risks that you identified that caused me to ask these questions.

And if you will allow me to speak generally—and know that this is a complicated problem—I am looking at it this way: We have "X" number of SROs, a lot. We shouldn't start with the idea that everybody gets all of the data, then maybe we peel back a little bit. We should start with the idea that the SEC gets all of the data, because we need it, and then see what others need to do their jobs.

Because starting with, everybody gets all of the data, and then kind of peeling back, I don't think is the right perspective. I think starting with the idea that we at the SEC, with our cross-market obligations, have access to all of the data, but others get data as they need it to do their jobs—I don't want to keep them from being able to do their jobs, but let's scope the data consistent with the obligations they have.

Mr. DAVIDSON. Yes. When you say, "all of the data," I want to be sure that you are clarifying, "all of the data that is actually collected." Because you have highlighted the importance of, first and foremost, not collecting data that you don't need, and frankly, data that could—and I think the other thing that you have highlighted as a good measure is segregating the data that would be personally identifiable to a firm or individuals. So, I think those are good controls.

And while I understand that perhaps not all of the SEC staff recommendations may be made public, would you be willing to share with our office or with members of this body how we could collaborate in this effort?

Mr. CLAYTON. I think we are doing a good job collaborating already. And that, what I will say, philosophy that I just described of, "what data do you need to do your job," not, "here's the data, figure out how to do your job," is the right way to approach this.

Mr. DAVIDSON. Okay. I hope we can collaborate a little more closely, frankly.

But I want to mention cryptocurrencies, or digital assets, as they are more correctly known, because most of them don't aspire to be actual currencies, and many of them don't even want to handle payment systems.

So I would just encourage you and the staff to continue to look at a truly nonpartisan bill, the Token Taxonomy Act, because it provides a bright-line test applicable to digital assets. And it is not a change of the Howey Test; it is an application to this field.

And I would say lastly, I joined more than 100 colleagues to express our concerns in the commercial mortgage-backed securities (CMBS) market. And a lot of us are very concerned that the commercial space is going to be—it was immediately disrupted because it is so highly liquid and very sensitive to—no buy side for anything, frankly, to the point where the Fed had to intervene even through municipal bonds.

So when you had this margin call death spiral that was going on for all sorts of things in March, the Fed provided essential stability for most things but not much on CMBS. And many firms have already gone bankrupt in that space. This wasn't bankruptcy because of lack of collateral; it was bankruptcy due to a complete lack of liquidity.

And now we are looking at a similar challenge, where people aren't facing challenges because they lack sufficient collateral; they are lacking a market structure that can deal with it. Are you working on this?

Mr. CLAYTON. We are.

Mr. DAVIDSON. I look forward to that. My time has expired, unfortunately.

I yield back.

Chairman SHERMAN. Mr. Vargas is now recognized for 5 minutes.

Mr. VARGAS. Mr. Chairman, thank you very much for holding this hearing. I appreciate it very much.

And, Chairman Clayton, thank you for being here. I do apologize, I stepped out for a little while to vote, so I didn't hear all of your testimony, but I have been here since the beginning.

But I did want to ask you, have you ever been a prosecutor?

Mr. CLAYTON. I have never been a prosecutor, but I am not going to—I don't want to—

Mr. VARGAS. It is just a simple question. I am just asking you, have you ever been a prosecutor?

Mr. CLAYTON. At the SEC? I oversee—

Mr. VARGAS. Anywhere.

Mr. CLAYTON. I oversee 1,300 enforcement attorneys. We have brought 2,000 cases in the that time I have been there. We have collected over $10 billion in fines and disgorgement, and returned $3 billion to harmed investors. Many of the people who work under my oversight at the SEC are former prosecutors. So, I hope that gives you comfort in your question.

Mr. VARGAS. I have to say, I haven't known you for the decades that some of my colleagues have, who have certainly said sterling things about you today, but I do know your reputation for integrity. That is all I have heard about you in the past. So, we may not agree on everything, and there are some corporate governance issues that I want to ask you about, but my understanding is that you have a reputation for great integrity. That is my understanding.

Mr. CLAYTON. Thank you.

Mr. VARGAS. I would just refer you to some of the generals who came in with great reputations for integrity and effectiveness, and what they were called by this Administration on the way out or since they had left certainly has left their reputation in tatters. I would just refer you to them.

I do want to ask you, however, about the ESG disclosures. Last month, the Investor Advisory Committee (IAC) recommended that the Commission promulgate environmental, social, and governance disclosure standards and incorporate the disclosures into the broader disclosures regime of the SEC-registered issuers. Similarly, the Asset Management Advisory Committee (AMAC) echoed the IAC's calls for ESG disclosure standardization.

As you may or may not know, in December 2019, this committee passed my bill, H.R. 4329, the ESG Disclosure Simplification Act of 2019. This bill, among others, requires public companies to disclose certain ESG metrics, and directs the SEC to establish a rule delineating which metrics must be disclosed.

What are the Commission's next steps on ESG disclosures, and how does the Commission plan to bring clarity to ESG disclosures and improve the current market-based ESG reporting framework?

The reason I ask this is because I think this terrible COVID-19 might be a terrible precursor for climate change.

Mr. CLAYTON. I have been very transparent about my views on ESG disclosure. In fact, on Tuesday, I believe it was, I appeared for an hour to discuss this topic and how to get more meaningful disclosure to investors.

Let me be clear: I believe that there are environmental ("E") topics for a number of companies that are extremely important from a disclosure perspective. I also believe that there are social ("S") topics, and there are governance ("G") topics.

Let's put "G" to the side, because we have a tremendous amount of "G" disclosure. If you talk to investors, it is very clear that they can understand how a company is governed from the disclosure we have, and compensation, and the like.

If you don't mind, I will go to "E" disclosure, where we are working both domestically and internationally on trying to get what I will say is more robust data, but on a sector-by-sector basis. Because it is very different from sector to sector, "E" information is important to investors.

For property and casualty, if you have a property and casualty portfolio, if it is along the coast, the modeling of potential losses and the like from different climate scenarios, that is important to investors. But if you look at a manufacturing facility, a company based in, let's just say the Midwest—

Mr. VARGAS. It depends on where it is, of course.

Mr. CLAYTON. Of course. It is a completely different scenario. And in some cases, companies can adjust, and in other cases, they are price-takers in this space.

I do believe, through my work with the International Organization of Securities Commissions (IOSCO) and, in particular, with my friend, Erik Thedeen, in Sweden—we have been working collaboratively on a taxonomy—that we are getting there. We are not just going to use blunt metrics, but we are going to have principles-based and good disclosure.

Mr. VARGAS. My time is almost up, and I was going to ask you about corporate governance. But I do want to ask you about diversity, in my last few minutes here.

Obviously, there needs to be more diversity, I believe, both in the financial services industry at the highest level, but also at the SEC. Could you just comment on that in the few seconds I have left?

Mr. CLAYTON. This has been a focus of mine since arriving at the SEC. We have made progress, but we need to make more progress.

We have brought diversity and inclusion and opportunity not just as something that is in an office or is in a training program, but I believe we are bringing it into the fabric of the SEC. We are integrating our Office of Minority and Women Inclusion (OMWI) into our hiring processes, and our processes for identifying people on committees. Our Asset Management Advisory Committee is holding a special roundtable next month, so this is something that I am committed to.

Mr. VARGAS. Thank you for your service. I appreciate it.

Thank you, sir.

Chairman SHERMAN. Thank you.

Mr. Hollingsworth is now recognized for 5 minutes.

Mr. HOLLINGSWORTH. Mr. Chairman, I wanted to talk about a few things, but I probably won't take my full time.

First and foremost, I wanted to commend Mr. Vargas on his work with regard to ESG. This is important work, and I appreciate what you have done, also, in developing a taxonomy, a language that is clear, that helps investors and doesn't muddy the waters with regard to what disclosures should be necessary for companies. So, I appreciate that, and I appreciate Mr. Vargas's leadership on that.

In addition to that, I wanted to thank you, Mr. Clayton, for some of the recent work you have done on extending the exemption for Section 404(b). This was a bill that Representative Sinema and I introduced last Congress, with strong, bipartisan support. Representative McAdams, across the aisle, and I introduced it last year. And I know you have done great work on this already, and I really appreciate that.

And for the many, many companies that will benefit from that and can pour more of their dollars into research and development instead of unnecessary and burdensome compliance, they appreciate it, as well, back home. So, thank you for that.

Second, I had recently written you a letter, a couple of months ago—admittedly, you have had a lot going on—about how we could reduce some of the barriers to liquidity for angel and early-stage investors by modernizing the definition of, "venture capital fund."

I wanted to make sure that I followed up with you on that just to say, this continues to be important and continues to be ever more important given some of the dynamics that are going on in our early-stage companies.

And I would appreciate, should time allow, getting a response on that so that we can move that ball forward. This is something that

I am working on bicamerally and bipartisanly to find a solution for, so if we could get back on that, it would be great.

In addition to that, I wanted to cover two abstract topics.

In March, everyone saw the markets go down, and everyone immediately assumed that something must be wrong. Can you clarify really briefly that markets going down, even significantly in a single day, or significantly in a single month, is not dispositive, or conclusive that something is wrong or is not functioning in the markets?

Mr. CLAYTON. What I can say is we have been monitoring the markets throughout—this is the greatest period of uncertainty in terms of economic performance that I have seen in the real economy.

We had a financial crisis. During that period—look, I don't want to do any victory laps or anything like that, but the market has performed incredibly well.

Mr. HOLLINGSWORTH. Right.

Mr. CLAYTON. Now, it required action by the Fed, by the Treasury, by us, and by private-sector participants. But the fact that capital and credit continued to flow throughout the system was exactly what you would want.

Mr. HOLLINGSWORTH. Exactly.

And just to crystallize that very point, as you articulated very well, it is important for us to remember that circumstances also change. And there are reasons to believe that companies might be valued less than they were in February on account of what their discounted cash flows might be in the future. That is signs of markets working, not necessarily markets not working.

I also wanted to also bring up materiality, because I know that there are several bills that are being considered in this committee right now that I believe may be redundant, where companies need to disclose if there might be a material impact to their supply chain, and disclose if there might be material impact to their workforce.

As I understand it—and, again, I am no SEC lawyer, but those things that are material, that management believes are material to their business, and may have a material positive or negative impact on their business need to be disclosed already. Is that true or untrue?

Mr. CLAYTON. That is a generally correct statement about disclosure.

And we have put out guidance. We tried to act quickly and say, look, we have a principles-based disclosure system. Here are the things that you should consider when making your disclosure: What is your liquidity position? How are your operations affected? What is the health and safety of your workers?

Mr. HOLLINGSWORTH. Right.

Mr. CLAYTON. Access to these things.

And I don't want to grade people, but overall, the disclosure in first-quarter earnings, through that cycle, was extremely strong.

Mr. HOLLINGSWORTH. Right.

Mr. CLAYTON. I think it gave investors confidence that companies were telling them exactly where they stood.

As we go into second-quarter earnings, let me take this opportunity to say, I expect companies to be as forthcoming and as comprehensive as possible in doing so, from the lens of how management and the board of directors are looking at the business and its prospects. I would rather have bad news than no news.

Mr. HOLLINGSWORTH. Agreed.

Thank you so much. I appreciate you being here.

I yield back.

Mr. HUIZENGA. Will the gentleman yield?

Mr. HOLLINGSWORTH. The gentleman will yield.

Mr. HUIZENGA. Thank you.

I wish my friend—and he is a genuine friend—from California was still here.

Mr. VARGAS. He is here.

Mr. HUIZENGA. Oh, he is here. Good. He can hear.

I wanted to ask a rhetorical question. He was asking you early on about whether you had ever been a prosecutor. I think some of us, maybe, want to ask how many members of this committee have been bankers or insurance agents or Section 8 housing providers? Precious few, I might note.

This is the type of place where a licensed REALTOR or a CPA has—

Chairman SHERMAN. The time of the gentleman has expired.

Mr. HUIZENGA. —become Chair of this committee and served well.

Chairman SHERMAN. Your point has been made. The time of the gentleman has expired.

Mr. HUIZENGA. Thank you.

Chairman SHERMAN. And now, also participating by Webex, Mr. San Nicolas.

Mr. SAN NICOLAS. Thank you, Chairman Sherman.

Good day to you, Chairman Clayton.

And just to answer my colleague's question, I do have prior banking and investment advisor experience. So, there are those of us within the committee who do provide it, and we are more than happy to engage with our fellow colleagues in order to provide perspective, to include theirs. Because when it comes to financial services, it is important for us to have the mindset that it impacts the entire country, not just those who have the specialty or the expertise.

That being said, Mr. Chairman, I wanted to first recognize my colleague, Chairman Meeks, who opened the door to what I wanted to talk about, which is the concern about potential overexposure of retail investors under current market circumstances.

We have seen a lot of new market participants engage in active trading activities, to include day-trading and swing-trading. But of late, there has also been a much larger increase in the access of retail investors to, as you mentioned, Chairman Clayton, some exotic instruments—derivatives, options, naked calls—being able to purchase these kinds of assets, these kinds of trading vehicles, these kinds of hedge instruments even on margin.

And so I wanted to—you were speaking about it earlier before time expired. Before I go into my questions, I wanted to go ahead and afford you a few moments to go ahead and make your statement on the risks that you are seeing with respect to retail investor overexposure.

Mr. CLAYTON. Thank you for the opportunity, because what I want to say to our retail investors is, when we have times of volatility, you hear stories of people making a great deal of money as a result of buying low and selling high, and perhaps even doing so on a leveraged basis or through options.

And you know what? Our kind of investor is the long-term retail investor. There are significant risks in taking those short-term, leveraged, margin positions. Unless you understand those risks and are able to bear those risks, you should not be doing it.

Mr. SAN NICOLAS. Thank you for that, Mr. Chairman.

And on to my questions. While individual investors and traders, of course, have their own responsibilities in the decisions they make in the capital they put at risk and the leverage they expose themselves to, the platforms that make those trades available to the investors and traders also have a responsibility. They have a responsibility to ensure the suitability of the individual making those trades.

And so I wanted to ask, given the increase in retail investor activity, has the SEC enhanced its review of trading platform due diligence in ensuring that the investor has a suitability test, a proper suitability test, for access to day-trading, derivatives trading, and margin access?

Mr. CLAYTON. We are looking at this issue. Let me try and break it down.

There are self-directed accounts, where you are not dealing with someone who has our new Regulation Best Interest (Reg BI) obligation, which goes in at the end of the month and which I believe will—and I am making this clear to brokers right now—should, through the care obligation, make sure that investors do understand those risks and are able to bear those risks as appropriate.

We are looking at the self-directed aspects of our market ecosystem and whether the—let me put it this way: The access to those is being granted as appropriate.

Mr. SAN NICOLAS. Thank you, Mr. Chairman.

And I guess, to close, I really think it is important for the SEC to circle back on this and make sure that even the self-directed accounts have the proper disclosures, but, more importantly, that it is being done in a way where the investor fully understands the risks with which they are getting themselves involved.

Because not only are we talking about potential overexposure of an individual investor, but there is going to come a time, if we are not careful, that we are going to be having counterparty risk and we are going to be having those kinds of situations where a whole group of individual investors, potentially making a lot of leveraged, derivative, bad decisions, are going to begin impacting the ability of the markets to function in an orderly way.

And while we may look at that and think that it might not necessarily present itself, that is exactly the same kind of mentality that we had prior to the subprime crisis, when we thought that tranching everything and spreading out the risk was good enough. And so, Mr. Chairman, I just ask that you keep a very close eye on this in order to not only protect our retail investors but to ensure our orderly markets.

Thank you, Mr. Chairman, and I yield back.

Chairman SHERMAN. Thank you.

The witness should know that we have about 8 to 10 additional speakers, so you will be out of here in less than an hour. We do not intend to have a second round.

I now recognize the gentleman from Ohio, Mr. Gonzalez.

Mr. GONZALEZ OF OHIO. Thank you, Mr. Sherman, for holding this hearing today.

And, of course, I want to thank you, Chairman Clayton, for being with us today and for all your work at the SEC.

I first want to acknowledge and thank your team for working with the other regulators on reforms to the Volcker Rule. I led a letter this past December encouraging regulators to amend the rule to exempt qualifying venture funds from the definition of, "covered fund," in order to help spur investments in States like mine, Ohio, that are in additional need of start-up capital. But thank you for that.

Additionally, I want to thank you for your recent response to a letter that I wrote with my friend, Mrs. Wagner, in support of additional access for retail investors to private markets. You and I have spoken about this privately.

[Audio interruption.]

Mr. GONZALEZ OF OHIO. Always fun with the technology.

But, as you are aware, the number of publicly listed companies has gone down significantly, while some of our fastest-growing—Uber, Lyft, Slack, et cetera—accumulate a significant amount of the growth in the private markets before going public.

It has always been my belief that we must do more to safely provide everyday Americans access to those opportunities to the extent we can.

My first question on that front is, in your response to my letter, you stated that closed-end funds could present an avenue for expanding investment options for Main Street investors. Can you discuss more about why you think this? And, also, what are the current roadblocks?

Mr. CLAYTON. Sure.

My objective is for our retail investors to have access to investment opportunities that are aligned with professionals. One of the great things about our public capital markets is that retail sits right beside institutional, and they get the benefit of that professional alignment of interest. When you move into the private markets, you want to make sure that you maintain that alignment of interest. And I believe that closed-end funds are one option for being able to do that. But you have to have that alignment of interest, and you have to have, what I would say is low cost—reasonable cost of access. But I think we are exploring ways to do that, and we are making progress.

Mr. GONZALEZ OF OHIO. Thank you. And I am excited about the progress that you have made on that.

As a follow-up, what are you currently doing to promote closed-end funds as a way to access private markets? Is there any consideration of rescinding the staff guidance that prohibits closed-end funds from investing more than 15 percent of their assets in private funds unless the sale is limited to accredited investors?

Mr. CLAYTON. As part of our overall looking at it, we are, but it gets to liquidity. We have to make sure that we have the appropriate amount of liquidity, including in closed-end funds.

Mr. GONZALEZ OF OHIO. Great.

Shifting to China for a second, first, I want to reiterate support for Chairman Sherman and Senator Kennedy's legislation, which I have joined, to what I would call have China play by the same rules as the rest of the companies in our stock exchanges.

Building off of the need to further protect U.S. investors from China, just yesterday, the Financial Times published an article that linked to a recent Pentagon listing of 20 Chinese companies that have ties to the Chinese military. This includes two companies that are listed on the New York Stock Exchange.

Going forward, how do we make sure that investors have this information, especially since these companies are at greater risk of being targeted by United States sanctions, potentially?

Mr. CLAYTON. We have a disclosure-based regime, and it works. It has worked really well, because if you don't disclose appropriately—make material misstatements or omissions or commit fraud—we can come after you.

One of the things that institutional investors know, that retail investors should understand, is that our ability to enforce that perspective is not uniform across the world.

Mr. GONZALEZ OF OHIO. Right.

Mr. CLAYTON. And we need to take that into account. Investment advisors need to take that into account. Investment professionals need to take that into account. And these are the kind of challenges you face in a job like this. How much can disclosure can you do in circumstances like that?

Mr. GONZALEZ OF OHIO. Quickly, do you believe that information, being on a list of 20 companies, is material for U.S. investors?

Mr. CLAYTON. I am not going to make a blanket statement, but if you are considering what is material about your company or not material about your company, the fact that you may be subject to significant sanctions is something that you would want to ask that question and see if the company's operations and the like or its reputation or whatever—

Mr. GONZALEZ OF OHIO. Right. I would argue it is.

And with my last question, do you believe that China is—okay, I will submit it in writing.

Thank you, Chairman Clayton.

Mr. CLAYTON. Thank you.

Chairman SHERMAN. Ms. Porter is now recognized for 5 minutes.

Ms. PORTER. Thank you, Mr. Chairman.

And thank you very much, Mr. Clayton, for being here with us today and for your patience as we navigate this hearing.

You have recently been named as the likely replacement for Southern District U.S. Attorney Berman. The U.S. Attorney's Office, as you know, has been apolitical for over 200 years. Do you agree that it is important for the investigations undertaken by the U.S. Attorney's Office to be conducted in a nonpartisan manner?

Mr. CLAYTON. So, look, I am here as the Chairman of the SEC, but what I want to say about my work as Chairman of the SEC and our work in the Enforcement Division, which is akin to any U.S. Attorney's Office is, we undertake our work in an independent, nonpartisan manner.

Ms. PORTER. Terrific.

As the Chairman of the SEC, you spearheaded numerous rule changes, one example being the so-called Regulation Best Interest (Reg BI). Was that a nonpartisan proposal, yes or no?

Mr. CLAYTON. From my perspective, what we have done with—I am not sure what you mean by, "nonpartisan."

Ms. PORTER. Okay. Let me try this. Did the Reg BI rule change pass the Securities and Exchange Commission, the SEC, with bipartisan support?

Mr. CLAYTON. No, we—the—

Ms. PORTER. I think you are struggling toward, "no."

Mr. CLAYTON. No, I am not struggling. I am just making sure.

Ms. PORTER. Okay.

Mr. CLAYTON. The vote on the—Commissioner Jackson and—no, it did not have complete—

Ms. PORTER. Let's try this one more time. Did Reg BI pass the Commission with bipartisan support?

Mr. CLAYTON. No, it did not.

Ms. PORTER. No, it did not. Thank you.

What about your shareholder voting proposal? Did that get bipartisan support?

Mr. CLAYTON. As a proposal going out? No, it did not.

Ms. PORTER. Okay.

What about your proxy advisor limits proposal?

Mr. CLAYTON. No, that did not.

Ms. PORTER. What about your proposal to expand private markets?

Mr. CLAYTON. Pardon me?

Ms. PORTER. Your proposal to expand private markets?

Mr. CLAYTON. Are you talking about—we don't have a—do you mean harmonization, proposal for harmonization? I don't remember. I will assume you are right; it did not have bipartisan support.

Ms. PORTER. Okay.

So, Mr. Clayton, calling yourself nonpartisan doesn't make it true. And your leadership at the SEC is, to be generous, inconsistent with being nonpartisan. I think becoming a U.S. Attorney would require a big change in your approach from the SEC.

Do you agree that independence from the President is necessary to agency independence?

Mr. CLAYTON. So, look, wait a second. I just want to go back to the bipartisan/nonpartisan—I believe if you look at my voting record across the SEC, which is a pretty good—there are many times when I have voted with Democratic Commissioners, maybe both Democratic Commissioners, and not the Republican Commissioners, and vice versa. I vote the way I think I should, without regard to partisanship. That is what I do.

Ms. PORTER. Okay.

Mr. CLAYTON. That is what I would do in any job.

Ms. PORTER. Okay. Great.

Do you think that independence from the President is necessary to agency independence?

Mr. CLAYTON. I think agency independence is independence from—look, I interact with you people, I interact with agencies, I interact with others. Independence does not mean isolated, but independence means doing what you think is right based on your experience.

Ms. PORTER. Do you think independence from the President is possible if you and the President are golfing buddies?

Mr. CLAYTON. I absolutely do, because I do my job every day without fear or favor. And we do justice at the SEC. And I think if you look at the record of the SEC, it is absolutely clear.

Ms. PORTER. How many times have you and President Trump golfed together?

Mr. CLAYTON. I am not going to get into this.

Ms. PORTER. Is it a large number and you have trouble recalling it?

Mr. CLAYTON. No. No. No. Look, I have played golf with the President a handful of times.

Ms. PORTER. Okay. What did you talk about?

Mr. CLAYTON. Those are private conversations.

Ms. PORTER. Are you willing to affirm to this committee that you did not discuss any SEC business?

Mr. CLAYTON. There are no conversations that I have had that would make me in any way—in any way—uncomfortable with my independence.

Ms. PORTER. Wonderful. I am glad to hear that. Before you golfed with the President, did you ask the SEC Ethics Counsel to advise you on that decision?

Mr. CLAYTON. Yes.

Ms. PORTER. You did?

Mr. CLAYTON. Yes.

Ms. PORTER. And did they issue a written opinion?

Mr. CLAYTON. No. But I—the answer is, yes, I did.

Ms. PORTER. You did. Okay.

I want to turn to talking about your prior work at your law firm. In your time at Sullivan & Cromwell, did you ever serve on the plaintiff's side of any securities or other matters? Or were you solely defense counsel, defending organizations like Deutsche Bank and Goldman Sachs?

Mr. HUIZENGA. Time.

Mr. CLAYTON. Let me say what—

Chairman SHERMAN. The witness will be allowed to answer briefly, then we will go on to the next—

Mr. HUIZENGA. Mr. Chairman, the witness shouldn't be compelled to answer at all. The time has expired.

And I am sorry, Chairman Clayton. Welcome to your confirmation hearing.

Chairman SHERMAN. I have allowed other people to go a few seconds over.

Mr. GONZALEZ OF OHIO. Mr. Chairman, you did not. You cut me off 2 seconds early, actually.

Mr. HUIZENGA. Actually, that is absolutely correct.

Ms. PORTER. Mr. Chairman, may I be recognized? Because it is actually my time.

Mr. GONZALEZ OF OHIO. Not anymore.

Mr. HUIZENGA. Your time has expired.

Ms. PORTER. I would like to offer to allow Mr. Clayton to respond in writing, if that would be acceptable to him.

My question was, just to state it again because there was knocking and interruptions while I was speaking, was, are there—

Mr. HUIZENGA. Mr. Chairman, she is not recognized.

Chairman SHERMAN. Excuse me. The offer to get an answer in writing is fully consistent with committee rules. The hearing record will be kept open the usual number of days for people to submit questions in writing, and that could be a question in writing.

We expect a relatively prompt response to the written questions that are presented after the hearing. That is what we have done in every hearing.

We look forward to reading your answer, Chairman Clayton.

Mr. Steil is now recognized for 5 minutes.

Mr. STEIL. Thank you, Mr. Chairman.

And thank you, Mr. Clayton, for being here.

I would like to remind all of my colleagues that this is not a confirmation hearing. We are not the Senate. This is the House of Representatives. If a confirmation hearing is required, that would be the role of the Senate. And if somebody would like to participate in that, they are more than welcome to run for the United States Senate and participate in a confirmation hearing.

I would like to dive in as to the topic that we are here for today, which is about monetary policy, the state of the economy, and how we are keeping our capital markets strong during some of the most challenging times that we have seen here in a long time.

First off, Chairman Clayton, I want to start by thanking you for your work to improve oversight of proxy advisors. I also want to recognize Commissioner Roisman, who has been a valuable voice on this topic. As you know, I dealt with proxy advisors in my private-sector career, so I understand how important it is to get this issue right.

In the last few months, SEC Commissioners made a couple of public comments that I believe have been viewed by some as evidence that the SEC may be softening its approach as it relates to proxy advisor reform. Among other things, Commissioner Roisman suggested that the final rule may include a speed bump that limits the ability of investors to use so-called set-it-and-forget-it mechanisms to automatically populate electronic ballots with proxy advisors' recommendations. It seems like that might be a little bit different than the peer-review process that was outlined previously.

Could you comment on how the SEC intends to ensure that issuers have the opportunity to correct erroneous or misleading recommendations, that they are peer-reviewed, the speed bump process, and whether or not one approach is more favorable than the other?

Mr. CLAYTON. You have outlined the issue we are trying to address, which is, when you are making a voting decision, you have the best information that is available to you to make that decision in a timely manner.

And the process we have now can be improved; that is clear. And we are trying to improve it in a way that creates the least friction for people to be able to express their opinion. But the people who have to vote, they should have a robust amount of information. And to the extent practicable, it should be accurate. So, we want to make sure that the system produces that type of information.

And we got a lot of helpful comments, and other ideas. There is the speed bump that people mentioned. But that is where I am driving: transparency and good information.

Mr. STEIL. I appreciate your work and your colleagues' work on this important topic.

Do you have an estimate as to when you believe a rule may be finalized on this?

Mr. CLAYTON. Like I have done throughout my tenure, we put it on the agenda, and we try to get it done, on the time of the agenda. So our current agenda has it to be completed by the end of the fiscal year. I continue to expect that we will be able to complete it by the end of the fiscal year.

Mr. STEIL. I appreciate your work on the topic.

Chairman Clayton, as you know, emerging growth companies (ESGs) are, I think, a very valuable tool for helping startups focus on innovation and job creation and growth. I think the EGCs are especially important today as we deal with the ongoing coronavirus pandemic, since many investors are, in particular, in the biotechnology industry.

I am concerned that many EGCs are facing the loss of that status and may see significant increases in their compliance burdens in the near term as a result. I think the timing is unfortunate, given the economic and managerial challenges associated with the pandemic, as well as the role that the EGCs could really play in this recovery.

And so, I am working on legislation to ensure that EGCs that face a loss of their status can receive a short-term reprieve. I am not asking for you to comment specifically on the legislation; I know that you wouldn't be doing that. But can you comment on how the economic turmoil that we have been experiencing is impacting some of our emerging growth companies that need access to public markets?

Mr. CLAYTON. Let me say this: As a general matter, because of the actions of Congress, the Fed, and the Treasury, financing markets have been fairly open, both equity and debt. People have been able to term out their debt, they have been able to get liquidity, they have been able to alter their balance sheets, add equity to their balance sheets.

Always, as you go further down the size spectrum, similarly-situated companies almost always have a bit of a hard time. I think, by and large, EGCs have been able to get financing as well, but it is an area that we need to watch because, let me put it this way: It is much easier to allocate capital in a chunk to a large company than it is to allocate it in a chunk to a whole bunch of smaller companies. That is just something we have to recognize.

Mr. STEIL. Understood. I appreciate your time today.

And in respect to my time, I yield back. Thank you.

Chairman SHERMAN. Thank you.

The Chair notes that I actually care about the health of my colleagues, or at least most of them, and, therefore, I urge all Members to wear masks at all times.

With that, I now recognize Mrs. Axne for 5 minutes via Webex.

Mrs. AXNE. Thank you, Chairman Sherman.

And thank you for being here, Chairman Clayton. I appreciate it.

One thing that I hear constantly from companies is that their greatest asset, of course, is their people, and I couldn't agree more with that.

Chairman Clayton, I was hoping you could explain generally why you think understanding a company's workforce is crucial for investors to evaluate the company?

Mr. CLAYTON. It is a personal belief, through my professional experience, that the best companies are the companies that understand their workforce, however it is structured, in the best way.

More generally, and from a financial point of view, the contribution of human capital and employees in companies has increased in proportion. If you look at 30 years ago, plant, property, and equipment were a lot of the assets on the balance sheet. Today, the assets of a company are intellectual property, people, and the like, by and large. And so, yes, it is extremely important.

We have a pending rulemaking where we are going to encourage, through our principles-based disclosure system, companies to discuss their human capital as management views it: How do they evaluate it? How do they develop it? How do they increase the value of the company through their people?

Mrs. AXNE. Thank you so much. I completely agree with you on both a personal and a professional basis. I have spent my career working in that arena as well. And that is why I worked with Senator Warner to bring some light to this important piece of information.

I also think that the coronavirus has certainly highlighted some of those issues, especially when it comes to workplace safety and paid sick leave. And that is why I, along with Senator Warner, sent you a letter—I believe that was last month—urging some action to get more disclosure on this.

I didn't get a response to that letter, so, since you are here, is that something that you would support?

Mr. CLAYTON. Actually, you will get a response, but, in the meantime, I believe yesterday, we put out guidance for second-quarter earnings and things that people should think about in their earnings reports and their communications with their investors, and those types of issues were included in that guidance.

Mrs. AXNE. Great. I will absolutely take a look at that.

I just want to let you know, I do have some concerns. I appreciate your intent, but some of the concerns I have had are around the principles-based approach, I believe, which didn't require specific metrics. And as somebody who has spent my career working in strategic and organizational development, I know that companies are obviously already measuring these metrics and that turnover rate, for example, is something they all track and is very meaningful.

If the SEC gives management discretion in these disclosures, are you worried that it will result in some unclear information and it won't give the numbers necessary for company-to-company comparison or comparisons for a company over previous years?

Mr. CLAYTON. This is a really good discussion, because we are not saying, "Don't disclose the metrics." What we are saying is, "Disclose the metrics that you use." And if a company uses turnover calculated in a certain way, presumably they do it because that is how they are managing their business, and that is what the investor would want to know.

What I don't want to do is adopt a standard across a bunch of industries. It may be right for one industry in how management is using it, but it is not right for others. So what I don't want to do is get comparability, give up meaningfulness. And that is the tension we always have in terms of establishing metrics that are broad.

So, we very much encourage companies to share the metrics that they use, but take the pharmaceutical industry and turnover; very different from the tech sector, different from the transportation industry, and how they may look at it.

Mrs. AXNE. I appreciate that. And I think there is an opportunity to work through some of those issues.

I do think we are looking at a risk here, though, and I would advise you to take a look at the letter that I sent with my Workforce Investment Disclosure Act, which lays out some very specific disclosures that could be required. Workplace safety violations, for example, can tell you a heck of a lot about how many of these companies are going to get back online more quickly due to COVID.

But, moving on—we are running out of time—I wanted to just quickly turn to tax disclosures. As we all know, our large companies are only paying about half of what the statutory rate is. I am wondering if you could tell me if you think there is some opportunity for the SEC to be looking at country-by-country disclosures?

Mr. CLAYTON. You actually raise an excellent point. It goes to both points, on tax and on operational and safety issues. When you have these kinds of multinational companies, trying to give investors a flavor for what happens across those various jurisdictions is very important, and we look at that. I recognize and want to be clear that it is becoming an increasing part of how sophisticated investors look at companies.

Mrs. AXNE. I appreciate that.

I know we are out of time. I continue to make—

Chairman SHERMAN. Yes, we are out of time.

At this time, Mr. Gottheimer is recognized for 5 minutes.

Mr. GOTTHEIMER. Thank you, Mr. Chairman.

And thank you, Chairman Clayton, for being here today.

Given the COVID-19 pandemic and the current racial justice issues facing our country, I think we can all agree it is more important than ever that all Americans have equal and just access to credit.

Every year, 15.4 million Americans are victims of credit card fraud, or around 42,000 people every day. The Federal Trade Commission (FTC) has previously found that 1 in 5 consumers have verified errors in their credit reports, and 1 in 20 consumers have errors so serious that they could be denied credit or forced to pay higher interest rates, affecting everything from small-business loans, to a mortgage, to a car loan. That adds up to 42 million Americans with errors in their credit reports, and another 10 million with errors that can be life-altering.

Next week, the House will consider my bipartisan legislation, the Protecting Your Credit Score Act, which will create a new online portal to provide Americans with free, unlimited access to their credit reports and scores, the ability to easily dispute errors and fraud, and the ability to secure and track their credit data, all to increase transparency and help Americans boost their credit and financial security through economic declines and beyond.

Chairman Clayton, are you concerned, particularly during the pandemic, about credit issues and Americans' ability to have transparency into their credit?

Mr. CLAYTON. Let me start by saying that, in general, access to credit, provision of credit is not within our authority. But I do talk about it a lot.

Mr. GOTTHEIMER. Yes.

Mr. CLAYTON. Because I always say to people, before you get involved in investing, understand your credit, get your credit under control. That is the best thing you can do for yourself.

Now, with respect to your question about access to credit and provision of consumer credit, we have a consumer-driven economy, to a large extent. I believe that the swift actions taken by Congress and by the Fed and the Treasury to enable credit to continue to flow have significantly dampened the negative effects of the COVID-19 response.

So, yes, having consumer credit that is appropriately priced and transparent is extremely important to our economy.

Mr. GOTTHEIMER. To that point, do you think we should make it easier for Americans to get their credit information for free and initiate disputes, given, I know, as you have pointed out, how important people's credit information is?

Mr. CLAYTON. I am going to stay in my lane as to particular policy rationale, legislation, and the like. That is not our area. I don't want to tread on other people's areas. But I affirmatively believe that having access to credit in a transparent way is important.

Mr. GOTTHEIMER. Thank you. And our legislation does just that. It puts a centralized portal that is managed by the credit bureaus to give people more information and the ability to dispute that.

Separately, AARP's Fraud Watch Network recently reported that there has been a steep increase in scams targeting the elderly and other vulnerable communities this month—I know this is part of your jurisdiction directly, that issue—that has been driven largely by the ongoing COVID-19 pandemic. These nefarious actors, both domestic and international, are using the pandemic and preying on people's fragile states during these uncertain times to target their hard-earned retirement accounts, their unemployment checks, and other savings.

Chairman Clayton, millions of seniors across the country have been the victims of financial scams, as you know, and been cheated out of their rightful retirements. I just wanted you to know—and I have talked to you before about our Senior Security Act. But, in general, do you agree that we should be doing everything possible to prevent our seniors from being robbed of their life savings?

Mr. CLAYTON. Yes, I believe we should be doing everything possible to prevent our seniors from being subject to fraud, particularly financial fraud.

Mr. GOTTHEIMER. Thank you, sir.

The Senior Security Act, which we have talked about, 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 and hucksters from scamming seniors out of their savings.

And, by the way, it has already passed out of the House overwhelmingly and bipartisanly, 392–20. It is now in the Senate. Would you support the legislation moving through the Senate?

Mr. CLAYTON. I am not going to support a specific piece of legislation here, but, as you have described it, we are doing this already at the SEC. We are happy to work with you. We are happy to follow the legislation, of course. If Congress tells us to do more, we will do more.

But I want you to know that we are already focused on seniors and making sure that seniors are having access to the products that are appropriate, not products that are inappropriate for them, and that they are not the victims of fraud.

Mr. GOTTHEIMER. I think that is part of your Retail Strategy Task Force, correct?

Mr. CLAYTON. That is correct. We have a Retail Strategy Task Force, but we also have people who are specifically focused on making sure that seniors—let me put it this way: Inspections, examinations, all of that, we have a senior focus.

And let me try and say this in a way that I am able—it is important to understand, when you look across accounts and you do surveillance and the like, whether accounts have seniors or not, which is one of the reasons why date-of-birth data or year-of-birth data is important in our oversight.

Chairman SHERMAN. Thank you.

Mr. GOTTHEIMER. And am I—

Chairman SHERMAN. The time of the gentleman has—

Mr. GOTTHEIMER. Thank you. Thank you very much, Mr. Chairman.

Chairman SHERMAN. Mr. Casten is now recognized for 5 minutes.

Mr. CASTEN. Thank you.

Thank you so much for your time, Chairman Clayton. If you are up to me, we are nearing the end.

Alexander Kearns was a college student in Naperville, Illinois, in my district. He had taken up trading during the COVID lockdown, and he recently took his own life when he saw that his Robinhood account had a negative balance of $730,000. Now, it turns out he didn't know that whole amount. But I want to just read you most of his suicide note that his father found.

"If you are reading this, then I am dead. How was a 20-year-old with no income able to get assigned almost $1 million worth of leverage? The puts I bought/sold should have canceled out, but I have no clue what I was doing now in hindsight. There was no intention to take this much risk."

Robinhood has added 3 million users in 2020. Now, it is my understanding that they have made some changes to their platform.

And Mr. San Nicolas spoke about protecting retail investors, and I certainly share your view that people should not take risks they can't afford.

Other than Reg BI, what is the SEC doing affirmatively to ensure that people like Alex can't get exposed like that again?

Mr. CLAYTON. Yes. We, at the SEC, along with the Financial Industry Regulatory Authority (FINRA) are looking at this kind of disclosure. And let me just say this: I read that over the weekend, and it is just terrible. We need to do something to make sure that these kinds of things don't happen.

Mr. CASTEN. I understand that you are, as you said, a disclosure-driven entity. But the disclosures are only as good as the understanding of the person who reads them.

Mr. CLAYTON. That is right. Let me just say that I agree 100 percent. That is what I was saying before: Disclosure is only good if people can understand it. And you have to be able to make an assessment of whether somebody can understand it.

Mr. CASTEN. I thank you for saying that.

I introduced, and we passed on the House Floor, H.R. 1815 the SEC Disclosure Effectiveness Testing Act earlier this term, specifically to do market testings of those disclosures. It was with Reg BI in mind, because if people can't understand in plain English what they are signing, then we haven't done our market research well enough. And we need to get it through the Senate, but I would encourage you to consider it. You could do that by rule. I urge you to take it up.

I want to turn to private markets and some of what my colleague from Wisconsin was raising. They require a lot less disclosure than public markets. Most of my career, prior to getting here, was running private-equity-backed companies. Complicated structures, very sophisticated people, constantly evolving capital structures. It was hard for me to keep up, and I was the CEO of the darn company.

This month, the SEC has proposed rules to expand exempt offerings in the private market. And given the issues and the lack of total understanding in public markets, can you just help me understand why you think we are protecting investors if we are allowing greater participation in private markets by people who would not pass the Reg D standard of a sophisticated or accredited investor?

Mr. CLAYTON. I think we are looking at this in exactly the appropriate way, from what you are describing.

Right now, we have a wealth test or an income test to ascertain whether somebody is sophisticated or not. And it is a binary test. I have long believed that is not the right test. But it is the test we have had. It is integrated into our ecosystem.

What we are doing is saying, are there better ways to test whether somebody should qualify as an accredited investor? And our proposal says one of the ways to think about it is, you pass the Series 7 exam. Were you able to sit down and pass the kind of exam that somebody who is selling securities has to pass? Do you understand things like exposure from options and the like? I believe that kind of component of the accredited investor test is important.

Mr. CASTEN. I agree, in principle.

And let me shift, if I may, to an area totally outside of your jurisdiction.

Mr. CLAYTON. Okay.

Mr. CASTEN. The Department of Labor this week issued an information letter under the Employee Retirement Income Security Act of 1974 (ERISA) to allow 401(k) plan sponsors to have private equity as a component of diversified asset allocation funds.

I am not going to ask you to speculate on ERISA. But is it your view that a 401(k) plan or an investor in a 401(k) plan would pass the sophisticated test that would allow them to participate in ways that would not frustrate the spirit of Section 506 of Reg D as currently written?

Put another way, can the Department of Labor make that change without you making a corresponding change in Reg D?

Mr. CLAYTON. The way that was structured is not directly investing in private equity by an ERISA plan. I read the letter. I thought it was structured very well, because it was: The ERISA plan fiduciary could pick a fund that has a fiduciary where the fund has limited exposure to private equity, but not direct investment by an ERISA beneficiary into private equity.

Mr. CASTEN. Okay. I am out of time, but we will follow up with you offline. Because I think there is a real concern that we could end up putting a lot of unsophisticated money in places that were hard for me, as the CEO of the company, to understand.

Mr. CLAYTON. I don't want that to happen.

Chairman SHERMAN. Thank you.

Mr. Budd is now recognized for 5 minutes.

Mr. BUDD. Thank you, Mr. Chairman.

And, Chairman Clayton, I appreciate you being here today in your capacity as Chairman of the SEC. I know there has been a lot of news, very exciting news, surrounding you lately, but I want to talk about U.S. accounting standards as a critical component of U.S. capital markets, the deepest and most liquid capital markets in the world.

And, for them to continue to operate efficiently and effectively, the U.S. must maintain accounting and reporting standards of the highest quality. This is particularly true in times of instability, similar to what we are experiencing during the COVID-19 pandemic.

As you are undoubtedly aware, I have long been an outspoken critic of the Current Expected Credit Losses (CECL) accounting standard, developed and implemented by the Financial Accounting Standards Board (FASB), as an entity over which the SEC has direct supervision.

Now, there were already serious concerns centered around CECL before the start of this pandemic, and this crisis has only further highlighted those concerns.

My question is, how does the SEC validate that all new accounting standards or significant revisions to existing accounting standards have been subjected to comprehensive field testing or economic impact assessments?

I just wanted to get your take on that, Mr. Clayton.

Mr. CLAYTON. I think that we should be looking at CECL's performance during this time period.

There are two perspectives from which people have been looking at CECL and how it operates. One is from a regulatory capital perspective, what impact it has on regulatory capital from the bank regulators' perspective. I am going to put that to the side.

From my perspective, and what CECL disclosure around expected losses is from the investor point of view, we have had some significant swings. There are some things that we need to look at, including whether different models used by comparable institutions produce significantly different results. If you have two financial issuers with the same balance sheet, or very similar balance sheets, that are coming up with different results, why is that happening, and do we need to make adjustments? Is somebody using a 2-year model versus a 1-year model? Is somebody significantly weighting unemployment in a time like this, when unemployment is at a level that no one really thought it would be?

So, that is a long-winded way of saying we should look at how CECL has performed in this time of stress and assess whether guidance, et cetera, whatever, needs to be made. But it is definitely something we should be looking at.

Mr. BUDD. Thank you.

Does the SEC conduct an independent assessment of investor relations to new or significantly modified accounting or reporting standards before they are finalized or issued? And, if so, why or why not?

Mr. CLAYTON. I think what you are getting at is our relationship with the Financial Accounting Foundation (FAF) and the Financial Accounting Standards Board (FASB), and their independence.

We do engage with them. I believe their independence is important. I think we have a very good relationship. And back to your CECL point, we are going to continue to work with them on evaluating how CECL has been implemented and how it is working.

Mr. BUDD. Thank you.

Would the SEC be open to formalizing through notice and comment their review process for new accounting standards?

Mr. CLAYTON. I think the process as it works today is a good process. I know that people are looking at—in particular, we are having this back-and-forth on CECL. I think people are looking at CECL and continuing to look at it with questions. But, overall, I think the current process is a good process. But I would be happy to continue to discuss that with you.

Mr. BUDD. I would like to do that. It seemed that was kind of made—it had the feel of being made without direct input of the SEC by an unaccountable board, and so I would like to continue that discussion. Thank you.

Does the SEC conduct independent investor outreach to invalidate investor considerations for accounting standards on a preissuance basis? And, if not, would the SEC be open to such a process?

Mr. CLAYTON. This is something that was important to me, and as we have looked at new trustees for the FAF and the FASB, I have made it a point to make sure that we have that investor perspective, so that that perspective is brought to bear on their rulemaking.

And, of course, they should be reaching out to people who are the—not just the preparers but the users of the financial standards.

Mr. BUDD. Very good. Thanks for being here today.

And I yield back my time.

Mr. CLAYTON. Thank you.

Chairman SHERMAN. I now recognize Ms. Dean for 5 minutes.

Ms. DEAN. Thank you, Mr. Chairman. I thank you for allowing me to be a part of this important hearing.

And I thank you, Chairman Clayton, for your service at the SEC during this crisis, this terribly difficult time for our entire country.

Mr. Chairman, I, too, would like to begin by discussing rating agencies. I am Madeleine Dean from suburban Philadelphia, by the way.

Last week, Federal Reserve Chairman Powell came before our committee, and he acknowledged that not all NRSROs have equal access to emergency lending facilities.

Since the Credit Rating Agency Reform Act of 2006 conferred sole supervisory authority of credit rating agencies to the SEC, I want to raise this issue with you today. Because these lending facilities do not treat all nine of the rating agencies equally or uniformly, I would like more insight on how the Federal Reserve came up with eligibility standards for rating agencies.

You have said in earlier testimony that there has been some conversation between the Fed and the SEC on this subject. Can you flesh out a little more what that conversation looks like? And what, if any, recommendations were made by the SEC to the Fed?

Mr. CLAYTON. I haven't been directly involved in those conversations, but let me give you my understanding of them. I did have a high-level conversation with one of my counterparts at the Fed.

What we have done is, if you look across those nine NRSROs, some of them participate in a wide variety of markets—corporates, products, and the like—and insurance, et cetera. Some of them only participate in very narrow aspects of the markets or have very limited participation in a market.

I am going to make up these numbers but get them directionally correct. You may have the insurance industry where 2 or 3 do 90 percent of the insurance industry, or there are a couple others that do just a few companies. We provide that data to the Fed, and then the Fed can see which NRSROs have sufficient experience to participate in the various facilities that they are using.

Ms. DEAN. Well, I am not actually—

Mr. CLAYTON. That is the conversation.

Ms. DEAN. Mr. Chairman, I am not actually thinking about markets or where they participate, because, as I understand it, NRSROs must satisfy the same criteria by the SEC.

So I am wondering, what is the internal distinction being made by the Fed? Is it your opinion that, after the SEC registers an NRSRO of a given asset class, that they should be treated uniformly?

Mr. CLAYTON. I think it is a really good question because it highlights the issue. Our registration does not qualify them for a particular asset class, or not an asset class; it is just a general registration as an NRSRO. So you can have somebody who is registered with us who doesn't rate corporate debt or has no expertise in rating corporate debt. It is not a merit analysis of their ability.

And I don't want to speak for the Fed. They do a good job at this. They need to look at the portfolio of ratings of those entities and assess whether they are appropriate for their facilities.

Ms. DEAN. I appreciate that. You may know—and this has bipartisan support, as you have heard today—that my bill, H.R. 6934, the Uniform Treatment of NRSROs Act, would help achieve this uniform treatment across the NRSROs.

Let me move on to pick up on the conversation that you had begun here with the very troubling firing of U.S. Attorney Berman, the U.S. Attorney for the Southern District of New York. You said you began a conversation with the Administration only this past weekend as to the possibility of you shifting to that position. Is that correct?

Mr. CLAYTON. Let me be clear. The weekend of the 12th was the initial conversation.

Ms. DEAN. Oh, okay. The weekend before the firing of Mr. Berman. That would be the week before.

Mr. CLAYTON. I'm sorry. I didn't hear that.

Ms. DEAN. That would be the weekend before the firing of Mr. Berman.

Mr. HUIZENGA. Mr. Chairman? The question—

Mr. CLAYTON. The weekend of the 12th.

Mr. HUIZENGA. Her question was inaudible, I think. She just needed—we needed to let—

Chairman SHERMAN. Please repeat your question.

Ms. DEAN. That would have been the weekend before the firing, the Friday night firing, of Mr. Berman.

Mr. CLAYTON. Yes, the weekend of the 12th.

Ms. DEAN. And you said you had had these conversations with others, about a wish to get back to New York, so you were looking for a position back in New York. When did you begin that conversation with either Attorney General Barr or the President?

Mr. CLAYTON. As I said, the first time it was raised was the weekend of the 12th, and I am going to leave it at that.

Ms. DEAN. It was raised by you or by—

Mr. CLAYTON. By me.

Ms. DEAN. —Attorney General Barr?

Mr. CLAYTON. Let me be clear on this issue. This was entirely my idea. This is something that I had been thinking about for several months as a possible continuation of public service after my time at the SEC is done.

Ms. DEAN. Okay. And you do not have a history as a prosecutor, but this was your idea. You suggested it to the Administration. Is that correct?

Mr. HUIZENGA. Mr. Chairman?

Chairman SHERMAN. Yes. I extended the gentlelady's time a bit for the technical problem, but the ranking member points out that the—

Ms. DEAN. Oh, thank you. I apologize. I did not have the timer visible to me. So, I apologize.

Thank you very much, Mr. Chairman.

Mr. CLAYTON. Thank you.

Chairman SHERMAN. Thank you. And you can submit questions for the record, and we do expect Mr. Clayton to respond.

Ms. DEAN. I will. Thank you very much. I yield back.

Chairman SHERMAN. And now, as our last questioner, I recognize the very distinguished gentlelady from Texas, Ms. Garcia, for 5 minutes.

Ms. GARCIA OF TEXAS. Thank you, Mr. Chairman.

And as a member of the Financial Services Committee and also the Judiciary Committee, I wanted to just pick up where Ms. Dean has left off.

Mr. Clayton, who approached you? You said it was the weekend of the 12th. Who approached you about it? Or did you approach the Administration? I just want to be clear on that.

Mr. CLAYTON. Let me be clear on this. And I don't—this is not a confirmation hearing. I am here as the Chairman of the SEC. But I want to be clear on how this came up.

This was entirely my idea. It was something that I had been thinking about, and talking about with others, as to whether I could go back to New York, which I had committed to my family to do, and I intend to do when I have finished my service here, and continue in public service.

This was a position that was very attractive to me, based on my work with the Southern District and my extensive work with people who are alumni of the Southern District. It is an incredible group of people. They work incredibly hard. They are dedicated to justice without fear or favor.

This was something of interest to me. It came up the weekend of the 12th. And that is the genesis for this. And I am going to leave it at that.

Ms. GARCIA OF TEXAS. Well, unfortunately, I can't. I think that you understand that—I understand and you understand this is not a confirmation hearing. But the reality is that you are before Congress, you are before a committee. And any time anyone comes to testify before the United States Congress, they know they are subject to just about any question about anything. And you may feel uncomfortable, you may not want to answer the questions, but until you run to be a Member of Congress, I get to ask the questions.

So, again, I am going to—

Mr. HUIZENGA. Mr. Chairman, a parliamentary inquiry. Is this line of questioning even relevant to the title or the subject of what our hearing is supposed to be about?

Chairman SHERMAN. The gentlelady from Texas is correct. You are a Member of Congress; it is your time.

If I start editing the questions, and comparing it to the title, and crafting the titles to exclude the questions that I don't want to hear, I am not sure you are going to be happy with the result. So—

Mr. HUIZENGA. It seems to me, Mr. Chairman, that it should at least be in the range—

Chairman SHERMAN. Your parliamentary inquiry has been responded to, and—

Mr. HUIZENGA. Okay. Parliamentary inquiry.

Chairman SHERMAN. —if you have an op-ed you want to write, put it in The Hill or Roll Call.

Mr. HUIZENGA. Mr. Chairman, a point of inquiry. Is it going to be your common practice to have discussion on issues that are outside of our—

Chairman SHERMAN. It is my practice as Chair to recognize a Member and to recognize that, as a Member of Congress, they can ask the questions they want, and to protect their time from interruptions.

I will ask the staff to restore about half a minute—

Mr. HUIZENGA. Mr. Chairman, okay, parliamentary inquiry on that. They stopped the clock when my inquiry started, so there is no need to add time.

Chairman SHERMAN. But the train of thought was certainly interrupted, so we will keep that in mind as we go forward.

I'm sorry, Ms. Garcia. And hopefully, there will be no further inquiries. You are recognized for the remainder of your time.

Ms. GARCIA OF TEXAS. Mr. Chairman, it is regrettable that he is refusing to answer a direct question from a Member of Congress. And the American people deserve to know some of these questions, because, yes, he did state earlier that this process did not require his current attention, the confirmation process, but the reality is, when you are a potential nominee or you are a nominee, it is all fair game, and the American people have a right to know.

But I will move on.

This past Wednesday, the Judiciary Committee heard from several employees of the Department of Justice—current and past—who have testified that the Department is pursuing cases based on the President's political and personal whims and not based on the rule of law.

For example, Mr. Zelinsky, a prosecutor on the Roger Stone investigation, testified that he was told the Department wanted to lessen the sentencing recommendation for Mr. Stone because the U.S. Attorney was afraid of the President, and so he agreed to treat Mr. Stone differently than any other person.

Mr. Clayton, should the President's friends be treated differently than other defendants?

Mr. CLAYTON. Let me tell you how we approach matters at the SEC and how I would approach matters anywhere. It does not matter who the subjects are; you pursue it without fear or favor and to do justice.

And that is the way that the people who have worked with me, the 1,300 people in our Enforcement Division at the SEC, have performed it, and that is the right way to go forward.

Ms. GARCIA OF TEXAS. I agree with you, without fear or favor is certainly the principle involved here. But what if you get an order? Do you believe the President has a right to tell you to lower a sentencing recommendation or drop charges entirely for his friends or for political allies?

Mr. CLAYTON. I am going to talk about the SEC. At the SEC, what we do is we approach this through our enforcement directors, through our staff. They are empowered to do what they think is right.

Ms. GARCIA OF TEXAS. Again, sir, I am asking you if—you want to be the U.S. Attorney. You said you have had oversight of prosecutors. Can you commit to us today to report any political influence or any kind of undue influence coming from the White House or the President or his agents to you or your office as U.S. Attorney if anything like that occurs, that you would report it to Congress?

Mr. CLAYTON. I can commit to continuing to do my job as I have and any other job like it as I have, which is without fear or favor, with independence, and without inappropriate influence.

Ms. GARCIA OF TEXAS. Right. I think in response to Ms. Porter's questions, you said that you had not had any discussion or any kind of influence either while you were playing golf with the President or any other time. Is that correct?

Mr. CLAYTON. What I am going to say is, I have conducted myself in my job in a way that I have not had any improper influence on any enforcement matter. I am completely confident in saying that.

Ms. GARCIA OF TEXAS. So you are—

Mr. HUIZENGA. Mr. Chairman?

Chairman SHERMAN. The time of the gentlelady has expired. I wish I could continue and allocate you more time, but the ranking member is being assertive here.

Ms. GARCIA OF TEXAS. Thank you, Mr. Chairman, and I yield back.

Chairman SHERMAN. Questions for the record will be submitted in the requisite number of days, which is 5 legislative days.

And we hope, Chairman Clayton, that you can get us an answer within a few weeks, a very few weeks, to those written questions.

Mr. HUIZENGA. Mr. Chairman?

Chairman SHERMAN. Yes?

Mr. HUIZENGA. I ask unanimous consent to enter into the record a June 24th letter from the U.S. Chamber of Commerce to both of us. The letter provides comments to the legislative text attached to this hearing. Apparently, they need to amend that to make this the confirmation hearing, but it is on the text of this attached hearing.

Chairman SHERMAN. Without objection, it is so ordered.

I would like to thank Mr. Clayton for his testimony.

The Chair notes that some Members may have additional questions for this witness, 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 this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

I remind Members to submit your written questions and materials for the record to the email address provided to your staff.

This hearing is adjourned.

[Whereupon, at 2:41 p.m., the hearing was adjourned.]

A P P E N D I X

June 25, 2020

Testimony before the
Investor Protection, Entrepreneurship, and Capital Markets Subcommittee
U.S. House Committee on Financial Services

"Capital Markets and Emergency Lending in the COVID-19 Era"

Jay Clayton
Chairman
U.S. Securities and Exchange Commission

June 25, 2020

Chairman Sherman, Ranking Member Huizenga and Members of the Subcommittee, thank you for the opportunity to testify today to highlight the U.S. Securities and Exchange Commission's response to the effects of COVID-19 on our capital markets.[1] COVID-19 has had profound effects on our capital markets and our broader economy. At the outset of the pandemic, in the interest of saving as many lives as possible, we—all Americans—have undertaken, with remarkable spirit and selflessness, a massive restriction in how we interact.

Many of the economic impacts of COVID-19 are a result of the collective, full-mitigation, health-and-safety-first response that resulted in a sharp contraction in many aspects of our economy and increased volatility and uncertainty in our capital markets. Policymakers have responded to the most apparent and acute economic and market consequences with unprecedented monetary and fiscal policy actions. The Commission's work has been and will continue to be an important factor in our nation's response to and recovery from the current COVID-19 pandemic. I also want to commend Congress and our regulatory colleagues, especially the Federal Reserve and the Treasury Department, for these swift, resolute responses to our nation's challenges.

More than half of American households are invested in our securities markets. The interests of these individuals—our long-term Main Street investors—are the primary lens through which we evaluate whether we are effectively advancing the SEC's mission. The 4,500 women and men of the SEC are committed to protecting these investors and the integrity of our markets. The uncertainties caused by COVID-19 have not changed our perspective or our commitment.

From an operational perspective, the SEC's efforts have centered, first and foremost, on the health and safety of our employees, the employees and customers of our registrants and individuals generally. Our health-and-safety-first approach framed our decision to begin shifting to mandatory telework in our Washington, DC headquarters and across our 11 regional offices in early March, and to date, the agency remains in a full telework posture with limited, mission-critical exceptions. Through this period of collective, national challenges, the Commission has remained fully operational and committed to our tripartite mission to protect investors, maintain

[1] The views expressed in this testimony are those of the Chairman of the U.S. Securities and Exchange Commission and do not necessarily represent the views of the President, the full Commission, any Commissioner or any other person.

fair, orderly and efficient markets and facilitate capital formation. The continued orderly operation of our securities markets over the past few months is a testament to the expertise of the dedicated women and men across the SEC, who have risen to the occasion and proven why their work is so important to the millions of Main Street investors and our markets. We recognize the importance of our mission to America's investors and our markets and believe it is a privilege to serve them.

In the remainder of my testimony, I will summarize some of the SEC's efforts over the past few months in response to the effects of COVID-19, including: (1) market monitoring and regulatory coordination; (2) guidance and targeted assistance and relief; (3) investor protection, education and outreach efforts; and (4) ongoing mission-oriented work of the Commission. My testimony also provides a brief summary of the SEC's FY 2021 budget request and approach to resource allocation during these challenging times.

Market Monitoring and Regulatory Coordination

In times of economic stress and market volatility, a key focus for the Commission is orderly and fair market function. Consumers, the thousands of firms and entrepreneurs that are working to fight and respond to COVID-19—not to mention the state and local governments, hospital systems, transportation and public services that are critical to the response—all depend on continued access to financial services and markets. The rapid fiscal, monetary and financial regulatory response to market and economic effects of COVID-19 has been both remarkable and appropriate. I believe these efforts to preserve the flows of credit and capital in our economy have significantly mitigated the economic consequences of COVID-19.

Market Function

Functioning of fair and orderly markets is essential to investor protection, and the continued orderly operation of our funding markets and other capital markets has been and will continue to be an essential factor in driving an effective national health and safety response to COVID-19. Despite the extraordinary volumes and volatility we have seen in our securities markets over the few months,[2] at a high level, the "pipes and plumbing" of our securities markets have functioned largely as designed, and importantly, as market participants would expect. In other words, during this time of unprecedented stress, we have observed no systemically adverse operational issues with respect to our key market infrastructure. We recognize that functional

[2] For example, from the equities perspective, the ten highest days by notional volume or trade count—*of all time*—occurred in 2020. In 2019, the average daily volume was 7.0 billion shares per day; on the last day of February 2020, we observed the second most shares traded ever, 19.3 billion shares. Equities volatility has also been high. For example, the "VIX" Index provides an options market-based measure of expected future volatility. At the beginning of January 2020, the VIX value was 12.5. On March 16, it reached an all-time high of 82.7. The volume and volatility story is similar in the corporate and municipal bonds markets, where the average number of daily municipal bond transactions in mid-February was approximately 34,000 and increased to 50,000 transactions per day in March, reaching 75,000 per day on March 23. *See* Remarks to the Financial Stability Oversight Council (May 14, 2020), *available at* https://www.sec.gov/news/speech/clayton-remarks-financial-stability-oversight-council-051420#_ftn6 (SEC staff prepared the various statistics cited based on data from various sources, including the World Bank, Bloomberg, Financial Industry Regulatory Authority, Municipal Securities Rulemaking Board and the SEC's Market Information Data Analytics System).

risks, including system and cybersecurity risks are ever present, and our staff are currently reviewing and will continue to review market function and whether additional improvements should be considered.

Market Monitoring

Staff across the SEC—including the Division of Trading and Markets, the Division of Investment Management, the Division of Economic and Risk Analysis and the Office of Municipal Securities—have been continuously monitoring our capital markets, including with respect to prices and price movements, capital flows and credit availability. In doing so, we have remained closely engaged with key market participants—including exchanges, clearing agencies, liquidity providers, public accounting firms and credit rating agencies—regarding market trends and developments and business continuity planning efforts.

Coordination has been central to these and other efforts. In late April, building on the Commission's ongoing market monitoring and response work, the SEC formalized an internal, cross-divisional COVID-19 Market Monitoring Group to 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.[3] In addition to the broad market-oriented work, we have also initiated work to: (1) identify, analyze and clarify interconnections across key segments of our financial markets with increased specificity; and (2) analyze the risks and potential procyclical effects of investment strategies and mandates that include or are subject to mechanistic rules, guidelines or restrictions on holdings of assets—for instance, by reference to ratings and downgrades.[4] This work supports and complements similar efforts being undertaken by our domestic and international regulatory partners.

Regulatory Coordination

During these challenging times, the SEC has remained in close contact with our U.S. and international regulatory partners. At the SEC, we have long recognized that close and active coordination with other financial regulators and public sector officials—both domestic and foreign—is fundamental to the fulfillment of our mission. The dedication, cooperation and engagement with these partners has benefited our work at the SEC, including helping to ensure that trading, settlement, capital formation and the provision of credit continues to be as orderly, efficient and fair as practicable under the circumstances.[5] This domestic and international engagement, including discussions concerning the innumerable linkages, interconnections and continually evolving dynamics between global banking, housing finance, commodities and other

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[3] *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.
[4] *See* Statement on COVID-19 Market Monitoring Group—Update and Current Efforts (May 13, 2020), *available at* https://www.sec.gov/news/public-statement/statement-clayton-kothari-covid-19-2020-05-13.
[5] For example, we have frequently sought and received guidance and assistance from our domestic regulatory partners, from which our efforts to facilitate market function and protect investors have benefitted immeasurably. We have also provided our expertise and perspectives on various responses to market developments, including, for example, capital markets advice concerning the design, establishment and potential impacts of funding, credit, liquidity and loan facilities.

markets and our capital markets has helped us identify areas of stress and vulnerability and potential mitigating actions.

Domestically, we have been engaged in regular—often daily—communication, coordination and information sharing with our fellow regulators and other authorities concerning risks and impacts resulting from COVID-19 on investors, companies, state and local governments and other issuers, and the financial system as a whole, including cybersecurity risks. This includes engagement with various personnel from the Department of the Treasury, National Economic Council, Federal Reserve Board, federal banking regulators and the Commodity Futures Trading Commission, among others. These efforts have occurred on both a bilateral and multilateral basis, including through participation in bodies such as the Financial Stability Oversight Council (FSOC) and the President's Working Group on Financial Markets (PWG), as well as ad-hoc multi-agency efforts. Additionally, we have engaged with members of Congress, congressional committees and staff on COVID-19 issues, including by providing briefings on Commission operations, securities markets conditions, impacts on investors and various regulatory responses.

Internationally, we have worked closely on capital markets-related matters arising from COVID-19 with our foreign counterparts and international prudential banking authorities on a bilateral and multilateral basis. Bilaterally, we have been in close coordination with authorities across the world, and in these exchanges, we have shared market and regulatory insights, as well as experiences and expectations on a wide variety of market topics, including areas of risk that may warrant increased attention. We have also played an active role in the response efforts of various international multilateral organizations, including by assisting with the development of and contributing to work streams organized by the Financial Stability Board (FSB) and International Organization of Securities Commissions (IOSCO).[6] These efforts have been focused on preserving orderly market function and decision-oriented analysis.

COVID-19 Related Guidance and Targeted Regulatory Assistance and Relief

The Commission and staff have been working to promptly provide guidance and targeted regulatory assistance and relief, where necessary or appropriate, to assist market participants in their efforts to continue business operations, including investor service operations, in the face of various challenges caused by COVID-19. Many of our actions have focused on operational issues, including facilitating the shift to business continuity plans that are consistent with health and safety directives and guidance.[7] Other actions have involved targeted, conditional and temporary relief relating to filing deadlines that could be significantly affected by COVID-19, guidance to promote continued shareholder engagement—including through virtual annual

[6] We have contributed, for instance, to multiple COVID-19 initiatives coordinated by the FSB's Standing Committee on Assessment of Vulnerabilities (SCAV) and Standing Committee on Supervisory and Regulatory Cooperation, as well as IOSCO's Financial Stability Engagement Group.
[7] For example, we have worked with various market participants to help facilitate the move by securities exchanges to an all-electronic trading environment.

shareholder meetings—for companies and funds, and responses to questions from investment advisers on conducting business from temporary locations.[8]

The Commission has also provided targeted relief to assist small business access to capital during these uncertain economic times. For example, recognizing the important role of business development companies (BDCs) in capital formation, particularly in small and middle-market lending, the Commission recently provided temporary relief to assist BDCs in their ongoing operations and in making additional investments in small and medium-sized businesses affected by COVID-19.[9] Additionally, based on feedback from the Small Business Capital Formation Advisory Committee, the Commission provided temporary, targeted and conditional relief to allow established small businesses access urgently needed capital in a timely and cost-effective manner through Regulation Crowdfunding, while continuing to provide appropriate protections for investors.[10]

A fundamental principle for the SEC and our capital markets has always been—and today is even more important than ever—the importance of issuers providing investors with financial and operational disclosures that are clear, high-quality and timely. Staff has been monitoring and providing guidance with respect to corporate and municipal filings and disclosures of U.S. issuers, as well as foreign companies listed in the United States. Additionally, we have been reminding issuers and others to continue to evaluate their obligations to make materially accurate and complete disclosures in accordance with the federal securities laws.

It is no surprise we have observed the presence of uncertainty regarding the financial and operating status of companies and municipal issuers, as well as their future prospects, and a resulting thirst for information from investors and the marketplace more generally. I believe that the timely disclosure of high-quality information—be it positive, negative or neutral, and be it definitive or subject to uncertainty in light of the circumstances—increases credibility and has a generally calming value that contributes to market function, and in turn, reduces the potential for systemic risk. In March and early April, we issued two public statements discussing the importance of corporate and municipal disclosures and urging issuers to provide investors with as much information as practicable regarding their current financial and operating status, as well as forward-looking information about their future operational and financial planning.[11] Earlier

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[8] For an overview of selected SEC response efforts to COVID-19, including guidance and regulatory assistance and relief, please see the SEC's "Coronavirus (COVID-19) Response" webpage at https://www.sec.gov/sec-coronavirus-covid-19-response.

[9] *See* Press Release 202-84, SEC Provides Temporary, Conditional Relief for Business Development Companies Making Investments in Small and Medium-sized Businesses, *available at* https://www.sec.gov/news/press-release/2020-84.

[10] *See* Press Release 2020-101, SEC Provides Temporary, Conditional Relief to Allow Small Businesses to Pursue Expedited Crowdfunding Offerings (May 4, 2020), *available at* https://www.sec.gov/news/press-release/2020-101. Two of the Commission's advisory committees, the Investor Advisory Committee and the Small Business Capital Formation Advisory Committee, recently convened special meetings—held virtually and broadcast live to the public—which provided the Commission with insight into the challenges faced by investors and small business during this time.

[11] *See* Statement on The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19 (Apr. 8, 2020), *available at* https://www.sec.gov/news/public-statement/statement-clayton-hinman; Statement on The Importance of Disclosure for our Municipal Markets" (May 4, 2020), *available at* https://www.sec.gov/news/public-

this week, the Division of Corporation Finance issued similar, updated guidance regarding second quarter earnings releases and other disclosures, and our Chief Accountant issued a statement on the continued importance of high-quality financial reporting for investors in light of COVID-19.[12]

Investor Protection, Education and Outreach

Investor protection is core to the SEC's mission. The SEC's Office of Compliance Inspections and Examinations (OCIE) and Division of Enforcement (Enforcement) remain fully operational and continue their robust efforts to protect investors.

OCIE has continued its efforts in examining registered entities for compliance with the federal securities laws, with a focus on the resiliency of critical market systems and verification of investor assets with financial professionals. Since mid-March, OCIE has supplemented its examinations with hundreds of outreach calls to registrants nationwide to assess the impact of COVID-19 on operational resiliency and business continuity planning. OCIE has also initiated numerous cause examinations based on information indicating potential fraud or investor harm and issued a number of risk alerts regarding issues LIBOR transition and observations regarding private fund advisers.[13]

Working with staff from across the agency and our regulatory counterparts, Enforcement has been actively monitoring our markets for frauds, illicit schemes and other misconduct affecting U.S. investors relating to COVID-19 and has dedicated significant resources to responding quickly to COVID-19 related misconduct. Since the spread of COVID-19 began, some companies have made potentially fraudulent or misleading claims related to access to testing materials, development of treatments and vaccines and access to personal protective equipment. To date, the Commission has issued over 30 trading suspensions where there have been questions regarding the adequacy and accuracy of information in the marketplace in connection with virus-related representations from issuers.

In many instances, after the Commission suspends trading in a security, Enforcement will continue to investigate whether an issuer whose stock has been suspended from trading or related bad actors were engaged in potential fraud or other misconduct, and the Commission has brought a number of enforcement actions against issuers and individuals alleging fraud based on

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statement/statement-clayton-olsen-2020-05-04. *See also* CF Disclosure Guidance: Topic No. 9: Coronavirus (COVID-19) (Mar. 25, 2020), *available at* https://www.sec.gov/corpfin/coronavirus-covid-19.

[12] *See* CF Disclosure Guidance: Topic No. 9A: Coronavirus (COVID-19) — Disclosure Considerations Regarding Operations, Liquidity, and Capital Resources (June 23, 2020), *available at* https://www.sec.gov/corpfin/covid-19-disclosure-considerations; Statement on Statement on the Continued Importance of High-Quality Financial Reporting for Investors in Light of COVID-19 (June 23, 2020), *available at* https://www.sec.gov/news/public-statement/teotia-financial-reporting-covid-19-2020-06-23.

[13] *See* Risk Alert: Observations from Examinations of Investment Advisers Managing Private Funds (June 23, 2020), *available at* https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf; Risk Alert: Examination Initiative: LIBOR Transition Preparedness (June 18, 2020), *available at* https://www.sec.gov/files/Risk%20Alert%20-%20OCIE%20LIBOR%20Initiative_1.pdf.

COVID-19 related claims.[14] Some of these COVID-related investment schemes have been part of alleged market manipulations seeking to dump the companies' stock into the market for purchase by unsuspecting investors.[15] These investigations are continuing, with many proceeding at an accelerated pace. Enforcement also released a statement reminding market participants of their obligations with respect to material nonpublic information, especially during times such as these where material nonpublic information may be more prevalent and arise in less common contexts.[16]

In addition to enforcement actions, the SEC—led by the Office of Investor Education and Advocacy (OIEA)—continues its important education and outreach to Main Street investors. OIEA, along with Enforcement's Retail Strategy Task Force, has issued investor alerts to inform and educate investors about concerns related to recent market volatility and COVID-19-related schemes,[17] as well as an alert warning investors of bad actors using CARES Act benefits to promote high-risk, high fee investments and other inappropriate products and strategies.[18] OIEA and the SEC's 11 regional offices have also continued targeted outreach events to retail investors, including to seniors, service members and other potentially vulnerable populations.

The SEC has also been preparing for the upcoming implementation of Regulation Best Interest (Reg BI) and Form CRS. Reg BI establishes a new standard of conduct for broker-dealers when making a recommendation of any securities transaction or investment strategy (including account recommendations) to a retail customer. Reg BI and Form CRS, together with the interpretations adopted contemporaneously by the Commission, will bring the legal requirements and mandated disclosures for firms serving retail investors in line with reasonable investor expectations, while preserving access (in terms of both choice and cost) to a variety of investment services and products.

Over the past year, the Commission and staff have engaged extensively with market participants and retail investors, as well as FINRA and other regulatory partners, and firms have made considerable progress in aligning their operations and preparing for the requirements of Reg BI and the obligation to file and begin delivering Form CRS. Based on this engagement—and importantly, because the continued implementation of these conduct and transparency initiatives, individually and collectively, will significantly benefit Main Street investors—we

[14] For a list of COVID-19-releated trading suspensions and enforcement actions, see https://www.sec.gov/sec-coronavirus-covid-19-response#list_ref_3.

[15] *See e.g.*, Press Release 2020-131, SEC Charges Microcap Fraud Scheme Participants Attempting to Capitalize on the COVID-19 Pandemic (June 11, 2020), *available at* https://www.sec.gov/news/press-release/2020-131; Press Release 2020-128, SEC Charges California Trader Engaged in Manipulative Trading Scheme Involving COVID-19 Claims (June 9, 2020), *available at* https://www.sec.gov/news/press-release/2020-128.

[16] *See* Statement from Stephanie Avakian and Steven Peikin, Co-Directors of the SEC's Division of Enforcement, Regarding Market Integrity (Mar. 23, 2020), *available at* https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity.

[17] See Frauds Targeting Main Street Investors—Investor Alert (Apr. 10, 2020), available at https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_frauds; Look Out for Coronavirus-Related Investment Scams—Investor Alert (Feb. 4, 2020), *available at* https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_coronavirus (both updated June 17, 2020).

[18] *See* COVID-19 Related Early Withdrawals from Retirement Accounts—Be Careful of Fraudsters and other Bad Actors Targeting Your Retirement Savings (June 3, 2020), *available at* https://www.sec.gov/oiea/investor-alerts-and-bulletins/covid-19-related-early-withdrawals-retirement-accounts-be.

believe that the June 30, 2020 compliance date for Reg BI and Form CRS requirements is appropriate.[19]

To help Main Street investors better understand Form CRS and its benefits, the Commission has established a new investor-focused webpage.[20] Additionally, I have highlighted areas where I believe may be necessary for firms to exercise increased care when making recommendations to Main Street investors—particularly under the current conditions—including rollovers and withdrawals from retirement plans, complex or risky products, COVID-related investments and special purpose acquisition corporations, or SPACs, and other companies with complex structures. As we proceed to the June 30 compliance date for Reg BI and Form CRS, and as the effects of the pandemic on our markets continue, the Commission will continue to focus on the interests of our Main Street investors, and we remain committed to enhancing the quality and transparency of their relationships with their financial professionals.

Ongoing Mission-Oriented Work of the Commission

Commission Rulemaking Agenda

While the agency is engaging on numerous COVID-19 initiatives as noted above, we have also continued our traditional mission-oriented agency functions, including rulemaking. Since the Commission began transitioning to telework status in early March, the Commission held two "virtual" open meetings and has continued to advance initiatives on the Regulatory Flexibility Agenda.[21]

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[19] *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#_ednref7. To the extent that a firm is unable to make certain filings or meet other requirements because of disruptions caused by COVID-19, including as a result of efforts to comply with national, state or local health and safety directives and guidance, the firm should engage with us. In April 2020, the staff also noted that during the initial period following the compliance date, SEC examiners will be focusing on whether firms have made a good faith effort to implement policies and procedures reasonably designed to comply with Reg BI, while also providing an opportunity to work with firms on compliance and other questions. The Commission and its staff have provided a number of resources to assist firms in understanding the new requirements and working toward implementation. *See* 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.

[20] *See* https://www.investor.gov/home/welcome-investor-gov-crs.

[21] *See* U.S. Sec. and Exch. Comm'n Agency Rule List (Fall 2019), *available at* https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235. As I have noted on a number of occasions, the Commission's Regulatory Flexibility Agenda is now constructed to enhance transparency and accountability to the public and Congress, in addition to providing a focal point for coordination within the SEC. Since 2017, these agendas have embodied a collective effort, benefiting from the input of my fellow Commissioners, our division and office heads and many members of our staff on key questions, including: (1) what initiatives the agency could reasonably expect to complete over the next 12 months, and (2) of those initiatives, which ones would have the most positive impact on our Main Street investors and our markets.

For example, the Commission has adopted rules to: (1) enhance the standards applicable to SEC-registered central counterparties and central securities depositories;[22] (2) implement congressional mandates to simplify the offering processes for closed-end funds and BDCs;[23] (3) reduce the burdens and costs for smaller issuers while maintaining investor protections through amendments to the accelerated filer and large accelerated filer definitions;[24] (4) improve the disclosures for variable annuities and variable life insurance contracts to help investors make informed decisions;[25] and (5) bring additional transparency, governance, oversight and financial accountability to the implementation of the Consolidated Audit Trail (CAT).[26] Additionally, as part of a broader, ongoing Commission effort to modernize the U.S. national market system to better meet the needs of investors, the SEC took a significant step by issuing an order requiring the submission of a plan to establish a new governance framework for the collection and dissemination of consolidated equity market data.[27]

During this time, our staff has continued to receive and review comments, as well as engage with the public on pending rulemakings through teleconferences and other modes of communication. The Commission expects to continue to make progress on the other items on our regulatory agenda over the coming months.

Investments in Emerging Markets, Including China

The Commission also continues to focus on other issues important to investors, including increased exposure to investments in emerging markets, such as China. Investments in emerging markets entail significant disclosure, financial reporting and other risks for U.S. investors. While the U.S. securities laws and regulations applicable to emerging market companies listed on U.S. exchanges are in many cases the same as (or comparable to) the laws and regulations applicable to U.S. public companies, the practical effects can be substantially different as a result of various factors. For example, the inability of U.S. regulators, in many instances, to inspect for compliance and the difficulty of enforcing these rules and regulations can significantly weaken practical effects.[28] I believe the status quo has come to be unacceptable, and this is an issue that should be emphasized to investors—particularly our Main Street investors. I am pleased the

[22] *See* Press Release 2020-86, SEC Enhances Standards for Critical Market Infrastructure (Apr. 9, 2020), *available at* https://www.sec.gov/news/press-release/2020-86.
[23] *See* Press Release 2020-83, In Response to Self-Executing Congressional Mandates, SEC Adopts Offering Reforms for Business Development Companies and Registered Closed-End Funds (Apr. 8, 2020), *available at* https://www.sec.gov/news/press-release/2020-83.
[24] *See* Press Release 2020-58, SEC Adopts Amendments to Reduce Unnecessary Burdens on Smaller Issuers by More Appropriately Tailoring the Accelerated and Large Accelerated Filer Definitions (Mar. 12, 2020), *available at* https://www.sec.gov/news/press-release/2020-58.
[25] *See* Press Release 2020-57, SEC Adopts Investor Disclosure Improvements for Variable Annuities and Variable Life Insurance Contracts (Mar. 11, 2020), *available at* https://www.sec.gov/news/press-release/2020-57.
[26] *See* Press Release 2020-114, SEC Adopts Amendments to the CAT NMS Plan to Improve Transparency and Financial Accountability (May 15, 2020), *available at* https://www.sec.gov/news/press-release/2020-114.
[27] *See* Press Release 2020-103, SEC Directs Equity Exchanges and Financial Industry Regulatory Authority to Improve Governance of Market Data Plans (May 6, 2020), *available at* https://www.sec.gov/news/press-release/2020-103.
[28] *See* Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited (Apr. 21, 2020), *available at* https://www.sec.gov/news/public-statement/emerging-market-investments-disclosure-reporting.

SEC staff will hold a roundtable on July 9 to explore ways to increase investor awareness of these risks and potential additional steps that can be taken to mitigate them.[29] I look forward to continuing to work with Congress and the PWG on this important issue.

Diversity, Inclusion and Opportunity

As the always important topic of racism, bias and racial injustice has become front of mind in our national discourse, I believe reaffirming our commitment to diversity, inclusion and opportunity at the SEC is of paramount importance. My many conversations with colleagues over the past few weeks on these critical topics have been personal and moving. These conversations—open, honest, respectful and supportive—I have had with individuals and groups, such as our Diversity Council, make it clear that, while we have made progress, the SEC as an organization wants to improve, and we recognize we should strive to identify and take actions that will drive sustainable progress. I greatly appreciate the leadership of Pam Gibbs and her colleagues in our Office of Minority and Women Inclusion (OMWI) for their work to facilitate dozens of meetings with divisions and offices across the Commission. Diversity, inclusion and opportunity are and must continue to be part of the fabric of our agency and that takes continued reflection and work from everyone involved.

While there will be many more initiatives in this area for years to come, I want to highlight a few recent efforts focused on enhancing diversity, inclusion and opportunity both at the SEC and in our capital markets more generally. In March 2020, the Commission released its first Diversity and Inclusion Strategic Plan, which will help guide the agency's ongoing efforts to enhance diversity and inclusion at the SEC and promote diversity and inclusion within the entities the SEC regulates.[30] Last week, the Office of the Advocate for Small Business Capital Formation hosted the SEC's 39th annual Government-Business Forum on Small Business Capital Formation, which included insightful panel discussions highlighting minority-owned and women-owned businesses and some of the challenges they face.[31] Importantly, on July 16, the Asset Management Advisory Committee will hold a public meeting on diversity and inclusion in the asset management industry.

FY 2021 Budget Request

Congress's support of the SEC through the FY 2020 enacted appropriation allowed the SEC to add a number of positions in key areas relating to enforcement and examinations, market oversight and outreach. The resources Congress has provided have also helped us better address our technology challenges, and we 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 and reduce our risk generally. These investments in technology, data analytics and market expertise have proven especially valuable in the SEC's response to COVID-19.

[29] *See* Press Release 2020-116, SEC Staff to Host July 9 Roundtable on Emerging Markets (May 19, 2020), *available at* https://www.sec.gov/news/press-release/2020-116.
[30] *See* https://www.sec.gov/files/2020_Diversity_and_Inclusion_Strategic_Plan.pdf.
[31] *See* Press Release 2020-133, SEC Announces Speakers for June 18 Small Business Forum: "Access to Capital: More Critical Now than Ever" (June 16, 2020), *available at* https://www.sec.gov/news/press-release/2020-133.

The SEC's FY 2021 request of $1.895 billion—a 4.4 percent increase over FY 2020 enacted levels—will allow the agency to better execute our mission and reflects the growing size and complexity of the markets we oversee.[32] This request supports key SEC priorities in furtherance of the agency's 2018-2022 Strategic Plan,[33] including: (1) facilitating Main Street investor access to long-term, cost-effective investment opportunities and expanding outreach to small businesses; (2) responding to continued evolution and innovation in our securities markets and meeting long-standing and emerging investor protection and oversight needs; and (3) assessing and securing our data footprint with a focus on cybersecurity.

With respect to COVID-19, the Commission's general approach for allocating resources, oversight and rulemaking functions at this challenging time is premised on: (1) putting health and safety first; (2) maintaining a high level of operational effectiveness; and (3) continuing to allocate our resources in the best interests of investors and our capital markets, with investor protection and market integrity remaining front of mind. This approach has allowed us to work quickly and transparently to respond to the economic risks of COVID-19 while continuing our other mission-focused work. While responding to the COVID-19 pandemic has required the SEC to reallocate certain resources to meet urgent needs, we do not anticipate needing additional resources beyond our FY 2021 request to continue responding to the effects of COVID-19 while advancing our mission on behalf of investors.

Conclusion

Thank you for the opportunity to testify today on a sampling of the SEC's work during this time and for Congress's continued support of the SEC, its mission and, in particular, its people. I look forward to working with you to address the effects of COVID-19 on our economy and investors, and more broadly, to advance our mission to the benefit of our capital markets and our Main Street investors.

[32] See Fiscal Year 2021 Congressional Budget Justification and Annual Performance Plan, *available at* https://www.sec.gov/files/secfy21congbudgjust.pdf.
[33] *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.

Council of Institutional Investors®
The voice of corporate governance

Via Email

May 19, 2020

Ms. Vanessa A. Countryman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **New Research on Harmful Impact of Proposed Changes to Resubmission Thresholds**
File No. S7–23–19: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8

Dear Ms. Countryman:

The Council of Institutional Investors (CII), appreciates the opportunity to provide this supplemental comment on the United States Securities and Exchange Commission's (SEC or Commission) proposed amendments to Rule 14a-8 in Release No. 34–87458, *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a–8* (the "Release").[1]

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management.[2]

On January 30, 2020, CII submitted a letter to the SEC that respectfully opposed the changes to Rule 14a-8 proposed in the Release (the "January 30 Letter").[3] Since then, we have conducted additional analysis of the impact the proposed changes would have, using shareholder proposal data for the period 2011 through the third quarter of 2019 to estimate the impact of the proposed rule on first, second and third-time shareholder proposals if the draft rule had been in place during the same period. We released the attached report on that analysis by CII Research Analyst Ernie Barkett on April 30.

[1] SEC, Release No. 34–87458, *Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a–8*, 84 Fed. Reg. 66458 (Dec. 4, 2019), https://www.federalregister.gov/documents/2019/12/04/2019-24476/procedural-requirements-and-resubmission-thresholds-under-exchange-act-rule-14a-8.
[2] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.
[3] In this letter, the terms "shareowner," and "shareholder" are used interchangeably.

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We found that the proposed changes would have a significant impact on several areas of concern for a wide range of CII members. Among other things, the proposed higher thresholds for resubmitting shareowner resolutions would have more than doubled the number of excluded proposals in the period 2011-2019, in particular reducing the number of shareowner proposals for independent chairs and to improve disclosure on political contributions and lobbying. This is a conservative estimate based on retroactive application of the proposed changes. Issuers have substantial opportunity to influence votes at the margins of a threshold. Therefore, it is likely that, if the changes are adopted, issuers will take extra steps to depress votes that are marginally more than 15 percent in the second year of consideration, or 25 percent in the subsequent year.

We also concluded that the proposed changes to Rule 14a-8 would make resubmission of shareholder proposals especially difficult at dual-class stock companies. The current thresholds already are high for public investors in dual-class stock companies. The most common dual-class structure provides that holders of super-voting shares, typically held mostly or completely by insiders, are entitled to 10 votes for every share held by public shareholders. For a hypothetical company at which super-voting shares account for 10 percent of common equity, presuming all shares are voted and that insiders vote against a shareholder proposal, the effective resubmission thresholds currently are 6 percent of shares voted the first year, 11 percent the second year and 19 percent the third and subsequent years. Under this hypothetical, the SEC amendments would effectively impose excessively high resubmission thresholds of 10 percent the first year, 29 percent the second year, and 48 percent the third and subsequent years.

Shareowner resolutions are an essential tool for expressing the collective voice of a company's shareowners on particular matters. They have made important contributions to corporate governance that have protected shareowners from the risk of management overreach, improved corporate efficiency and shareholder value, and enhanced investor confidence in U.S. securities markets. As we demonstrated in our January 30 Letter, consistent with other comment letters from numerous and diverse, individual and institutional shareowners, shareowner proposals have encouraged many companies to adopt governance policies that today are viewed widely as best practice. For example, electing directors by majority vote, rather than by plurality – a radical idea a decade ago when shareholders pressed for it in proposed resolutions – is now the norm at 90 percent of large-cap U.S. companies. Similarly, norms such as independent directors constituting a majority of the board, independent board leadership, board diversity, sustainability reporting, non-discrimination policies and annual elections for all directors all were advocated early through shareholder proposals. Many such, well-accepted governance practices took years to achieve that acceptance, necessitating resubmission of related resolutions to keep the ideas in circulation. The Commission's economic analysis should have, but did not, account for the opportunity cost of preventing, or even delaying, adoption of these and other corporate governance best practices.

The Release's claimed benefit from restricting shareowners' rights to resubmit such resolutions is $70 million in total for all companies. Most public companies do not receive shareholder resolutions and therefore would not receive any portion of the savings that the Commission estimates, which may explain why most companies did not submit comments advocating for the change. Only 13 percent of Russell 3000 companies received a shareholder proposal, on average, in the period 2004 to 2017. In other words, the average Russell 3000 company can expect to receive a proposal once every 7.7 years. For companies that receive a proposal, the median number of proposals is one per year. Of course, the market harm that would be caused by stifling shareowners' rights to develop and consider new ideas, over time, would be much greater than the de minimis benefits that would inure to the small set of companies that receive numerous resolutions every year. There are also unintended consequences that the Commission did not consider, such as that shareowners may react to the restrictions by resorting to blunter signaling mechanisms, such as votes against incumbent board members, and by supporting new ideas with undue haste, lest they lose their chance to consider them again in the future.

* * *

Public securities markets are a viable mechanism for capital formation due to the faith of dispersed investors that they will be treated fairly, including that our system of corporate governance allows them meaningful opportunities to communicate and signal preferences for how the companies in which they invest are governed on their behalf. Rule 14a-8 has been an important mechanism to support investor confidence in public securities markets. It has worked well for many decades, and it still works well today. Neither the Release nor the advocates of the change have provided a rational economic justification for limiting it.

Thank you for considering our comments and the retrospective analysis in our attached report. As always, we would be happy to discuss our analysis and findings as well as our concerns about the proposed changes to Rule 14a-8.

Sincerely,

Kenneth A. Bertsch
Executive Director

Jeffrey P. Mahoney
General Counsel

ATTACHMENT

Ernie Barkett, Estimating the Impact: The SEC's Proposed Rule to Curb Shareholder Proposals (April 2020)

Council of Institutional Investors®
The voice of corporate governance

April 2020

ESTIMATING THE IMPACT

The SEC's Proposed Rule to Curb Shareholder Proposals

By Ernie Barkett

Ernie Barkett is a Research Analyst at the Council of Institutional Investors.

Overview

The Securities and Exchange Commission (SEC) late in 2019 proposed significant new limitations on the use of shareholder proposals in amendments to Rule 14a-8 (the shareholder proposal rule).[1] The Council of Institutional Investors opposed the SEC amendments in a lengthy Jan. 30, 2020, letter.[2] A large number of other investors commented on the amendments, and most institutional investors that submitted letters were critical of the amendments.[3]

This report examines one element of the SEC amendments: the impact of the SEC proposal for very substantial increases in the hurdles to "resubmit" a shareholder resolution on a subject matter considered in an earlier year.

Shareholder proposals also would be limited in other respects by the SEC's amendments, including increased dollar share ownership requirements unless shares had been held at least three years; and various new red-tape requirements on shareholder proponents and limitations on their use of representatives.

In our view, the SEC has not done adequate work in examining the effects of any of these amendments. Without serious SEC research to provide data on the ownership requirements or on likely impacts of the proposals to increase procedural requirements for proponents, we find it challenging to measure potential impacts of those elements of the SEC amendments with any degree of accuracy.

However, we do have data to examine further the impacts of the proposed increased hurdles on resubmitting shareholder resolutions, which we seek to do in this report.[4]

Under existing SEC rules, a company may exclude a shareholder proposal from its proxy materials if a proposal on substantially the same subject matter had received, in any of the

[1] See 17 CFR Part 240 Release No. 34-87459; File No. S7-23-19, available at https://www.sec.gov/rules/proposed/2019/34-87458.pdf. Federal Register version at https://www.federalregister.gov/documents/2019/12/04/2019-24476/procedural-requirements-and-resubmission-thresholds-under-exchange-act-rule-14a-8.
[2] Letter to the SEC from Kenneth A. Bertsch and Jeffrey P. Mahoney, Jan. 30, 2020, at https://www.sec.gov/comments/s7-23-19/s72319-6729684-207400.pdf.
[3] See Comments on the Proposed Rule: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, at https://www.sec.gov/comments/s7-23-19/s72319.htm.
[4] The CII Research & Education Fund in November 2018 published a report on potential impacts of increasing resubmission thresholds, but that report did not consider specifically the thresholds eventually proposed by the SEC. See CII Research & Education Fund, *Clearing the Bar: Shareholder Proposals and Resubmission Thresholds*, at https://www.ciiref.org/resubmission-thresholds.

previous five calendar years, less than 3% of the vote if previously voted on once; less than 6% of the vote if previously voted on twice; or less than 10% of the vote if previously voted on three or more times.

The SEC proposed in November 2019 to raise these thresholds to 5%, 15% and 25%, respectively. In addition, the proposed rule would introduce a "momentum requirement," whereby a resolution resubmitted three or more times within five years also would be excludable if support declined by 10% or more relative to the previous vote result.[5]

This report uses shareholder proposal data for 2011 through the third quarter of 2019 to estimate the impact of the proposed rule on first, second and third-time shareholder proposals if the draft rule had been in place during the same period.

The 5/15/25 Thresholds

We estimate the 5/15/25 thresholds, paired with the 10% momentum requirement, would have more than doubled the number of proposals excluded.

Our methodology is somewhat rough, in part because it depends on interpretation of "substantially the same subject matter." One of the quirks of the shareholder proposal rule is that resolutions can be excluded that are deemed to raise "substantially the same subject matter" as an earlier proposal that received low support, even if the request differs (or is even opposite) the earlier resolution.[6] Also, we know that issuers can influence

[5] For example, if a proposal voted on three times in the previous five years most recently was supported by 36.0% of shares voted, and on the previous occasion support had been at 40.0%, the proposal may be excluded, since the vote went down by 10% (40 – 36 = 4; 4 is 10% of 40). The exclusion would not be available if the most recent vote was more than 50%. However, to take an extreme example, if the previous vote was 55.5% and this year's vote is 49.9% this year (a 10.1% drop), the proposal could be excluded next year on the theory that shareholders were losing interest.

[6] Proposals qualifying for exclusion under both the proposed higher resubmission thresholds and new momentum requirement were counted only once. This report does not purport to exactly replicate the impact of the proposed rule. Since the report builds from a finite data set beginning in 2011, it makes the false presumption that shareholder proposals appearing for the first time on or after 2011 were first-time submissions. Additionally, this report treats a proposal as excludable upon receiving less than 5% in its first appearance on the ballot, less than 15% in its second appearance, and less than 25% in its third or greater appearance. The proposed rule technically grants the right to exclude upon receiving, over a five-year period, less than 5% once, less than 15% twice, or less than 25% three times. Thus, this report accounts for a scenario in which a proposal appears twice in non-consecutive years as two separate first-time proposals.

votes at the margin, and likely would have taken extra steps to push votes down that were marginally more than 15% in the second year, or 25% in the third or subsequent year.[7]

Nevertheless, the research shows that a number of issues widely seen as important would have been no-go areas for shareholder proposals for a period of time had the SEC amendments been in force earlier.

Taken together, we find that the new thresholds would have more than doubled the number of excluded proposals in the period, from 221 to at least 514. Of 2,422 first-time proposals, 269 received less than 5% support, including 101 that were supported by less than 3% of shares and therefore already were excludable under the old rules.

Thus,168 first-year proposals received support greater than 3% but less than 5% of votes cast, and therefore would be "newly excludable" under the SEC amendments. In fact, only 79 of these 168 proposals were resubmitted, suggesting that many proponents do not continue to pursue subjects on which they do not immediately gain some traction with investors.

The first-year increase from 3% to 5% may be less concerning than the much more substantial second-year and third-year threshold changes, since the SEC would raise those much more substantially (each increased by 2.5 times). That said, many proposals that are voted on a second and subsequent time do receive very substantial support that is above the SEC's contemplated increased thresholds.

Of 740 second-time proposals, 36 satisfied the current 6% resubmission threshold to qualify for a third submission but did not reach 15% support and would be "newly excludable." Of these 36 newly excludable proposals, the fact is that under the old rules, only 14 were submitted for a third time; most were not resubmitted, again raising questions on the need for the amended thresholds if market participants already react to a signal sent by a relatively low vote. Of 157 third-time proposals that satisfied the current 10% resubmission threshold to qualify for a fourth submission, 86 received between 10% and 25% support. Of these "newly excludable" proposals, 49 (57%) were submitted for a fourth time.

[7] Relatedly, but not addressed in this report, the margin of error in vote counts appears to be significant in some cases, which becomes a larger issue in the "resubmission requirement" context with much higher resubmission thresholds.

New "Momentum Requirement"

The proposed rule introduces a "momentum requirement" permitting companies to exclude proposals submitted a fourth or fifth time within a five-year period if voting support declined by 10% (*not percentage points*) as compared to the immediately preceding vote. We find the momentum requirement, on its own, would have enabled the exclusion of 22 additional shareholder proposals, representing 7% of all shareholder proposals submitted four or five times within a five-year period. Unlike the higher thresholds, the momentum requirement would have impacted governance proposals considerably more than environmental or social proposals.

Overall Impact

We think it is not an accident that shareholder proposals that would be impacted most are those on subjects particularly sensitive to senior management and their lobbyists: proposals for independent board chairs and for better reporting to shareholders on lobbying activities and political contributions. Table 1 shows common shareholder proposals that would have been eligible for resubmission under the current thresholds but would not be eligible for exclusion under the proposed rule.

Table 1: Types of Proposals Most Affected by Rule Change

Proposal Type	Excluded by Threshold Requirement	Excluded by Momentum Requirement	Total Excluded
Require Independent Board Chair	28	4	32
Report on Political Contributions*	29	3	32
Report on Lobbying Payments and Policies	26	-	26
Exclude Abstentions in Vote Counting	11	-	11
Provide Right to Act by Written Consent	7	2	9
Incorporate Sustainability in Compensation	8	-	8
Adopt One Share, One Vote	7	1	8
Shareholder Approval of Contributions	7	-	7
Adopt Quantitative Goals on Emissions	6	-	6
Establish Human Rights Board Committee	6	-	6
Adopt Holy Land Principles	5	-	5
Adopt Proxy Access	5	-	5
Report on Sustainability	5	-	5

*Political contribution proposals include several that ask for reports on congruence between political contributions and stated values of the corporation.

Areas of Concern

CII is a "broad tent"; members have varying views on ESG issues, including matters raised in shareholder proposals. That said, we believe that a significant portion of CII's membership may be particularly concerned about impacts from the amendments on these proposals:

- **Proposals at companies that have dual-class stock with differential voting rights.** The current thresholds already are high for many or most dual-class stock companies. The most common dual-class structure provides that holders of super-voting shares, typically held mostly or completely by insiders, get 10 votes for every share held by public shareholders. For a hypothetical company at which super-voting shares account for 10% of common equity, presuming all shares are voted and that insiders vote against a shareholder proposal, the effective resubmission thresholds currently are 6% of shares voted the first year, 11% the second year and 19% the third and subsequent years. The SEC amendments would raise these levels in the hypothetical to 10% the first year, 29% the second year and 48% the third and subsequent years.[8]

  This hypothetical in real life understates the requirements, because while insiders are likely to vote all their shares, some significant portion of dispersed owners of low-voting shares are likely NOT to vote.

  We believe shareholders are less active in proposing resolutions at companies with dual-class stock, exactly because voting support is likely to be limited on a proposal opposed by the chairman/CEO, when the chairman/CEO controls most votes through super-voting shares. Nevertheless, some shareholders persist, and we do see support for a number of proposals at dual-class stock companies (including proposals asking the company to take steps to convert its share structure to one-share, one-vote).

- **Proposals advocating independent board chairs.** As indicated in Table 1, proposals for independent board chairs are significantly at risk from the SEC amendments, partly due to the momentum requirement. Chair/CEOs appear particularly keen in at least some cases to defeat proposals to separate the roles of chair and CEO, with companies sometimes spending significant resources to

[8] In the hypothetical the holder(s) of super-voting rights (with 10 votes per share) own(s) 10% of shares and control(s) 52.6% of votes. Holders of low-voting shares (with one vote per share) own 90% of shares and control 47.4% of votes. As indicated, the hypothetical assumes all shares are voted, and that the holder(s) of super-voting shares oppose(s) the proposal.

defeat these proposals.[9] Voting support varies significantly and can be volatile at companies. With typical votes at about one-third of shares voted give or take 10 points, these proposals are particularly at risk from the 25% vote threshold and from the momentum rule.

A notable illustration of this dynamic is provided by Boeing. where a 2018 proposal for an independent board chair garnered a 25.2% "yes" vote, down from 31.7% support in 2016, the previous time such a proposal came to a vote. The proposal could not have been refiled for 2019 if the momentum requirement been in effect. As it happens, under existing rules a proposal for an independent chair was voted on in a 2019 proposal, and support increased to 34.8%. There is no doubt this was influenced by subsequent events – two fatal air crashes and the grounding of the 737 MAX aircraft worldwide. Then, in October 2019, after increasing questions on handling of the crisis and apparently in receipt of expecting another shareholder proposal, and after a sharp decline in Boeing's share price, the Boeing board finally named an independent chair, citing reasons that a significant minority of shareholders had made for years. A shareholder proposal opposed by the board to adopt a policy of having an independent chair came to a vote in April 2020, and was approved, winning support from 52.9% of shares that were voted for or against the proposal.

- **Proposals asking for reports on political contributions and lobbying**. Proposals for better disclosure on political contributions and lobbying also appear particularly sensitive for senior management at some companies, and for management lobbying groups like the Business Roundtable, Chamber of Commerce and National Association of Manufacturers, which spearheaded the campaign that persuaded the SEC to propose limiting shareholder proposals. Our findings are similar to those of the Sustainable Investments Institute (Si2) that found that the proposed SEC rule, if in place from 2010 to 2019, would have

[9] There are many examples of significant company efforts to defeat proposals to separate the roles of CEO and board chair (or for the board chair to be independent, which entails the same outcome). A notable illustration was the campaign by JP Morgan Chase to defeat such a proposal in 2013, after the "London Whale" scandal threatened the continued dual roles of company Chairman and CEO Jamie Dimon. See, e.g., "Shareholders Denied Access to JPMorgan Vote Results," The New York Times, May 15, 2013, at https://dealbook.nytimes.com/2013/05/15/jpmorgan-voters-are-denied-access-to-results/ ("In the midst of one of the most closely watched investor votes in years — over whether to separate the roles of chairman and chief executive at JPMorgan Chase — that protocol has changed. The firm that is providing tabulations of the JPMorgan vote stopped giving voting snapshots to the proposal's sponsors last week. The change followed a request from Wall Street's main lobby group…"); "JP Morgan's Dimon to remain chair after votes," Reuters, May 21, 2013, at https://www.reuters.com/article/us-jpmorgan-dimon-edge/jpmorgans-dimon-to-remain-chairman-after-vote-reports-idUSBRE94K07420130521 ("the bank lobbied hard against the measure, with tensions rising in the run-up to the meeting").

reduced the number of proposals on political activity eligible for resubmission from 672 to 527, the largest impact (by far) on any shareholder proposal.[10]

Political contribution and lobbying disclosure proposals in some cases would have fallen victim to the SEC's momentum requirement, but the major impact is because the proposals typically get support ranging from 20% to 40%, and so would be vulnerable to the 25% threshold. These proposals have been pursued vigorously by proponents, in part because many companies eventually agree to improve disclosure; these resolutions often are resubmitted. Lobbying disclosure proposals are particularly vulnerable, averaging about 25% support.[11]

- **Proposals asking for stronger shareholder rights, including written consent rights and proxy access.** Shareholder proposals on core shareholder rights tend to get support from a range of institutional investors. These include proposals that the SEC amendments would have blocked, particularly concerning written consent rights and proxy access, as shown in Table 1.

- **Proposals on subjects that are ruled "out of order" for multiple years due to low votes on idiosyncratic, inartful or deliberately unpopular proposals on that subject.** The particular issue with proxy access proposals mentioned in the immediately preceding bullet point is that a version of the proposal submitted to some companies failed to win significant shareholder support. Because shareholder proposals on a given topic can be excluded for a number of years after failing the resubmission test, at the relevant companies this impeded adoption of a different proxy access proposal that was supported by many shareholders (generally winning majority support). With much higher resubmission thresholds, there is significantly greater risk that this dynamic will come into play more often, and even that shareholders who want to block a popular proposal will do so by submitting a proposal that is idiosyncratic, or even opposite of what most shareholders would support.

- **Proposals that would have been blocked that had gone on to win substantially increased support.** More generally, a number of the proposals that would have been blocked by the SEC amendments have gone on to win substantial support in later years – such as the Boeing independent chair proposal cited above. In our review, governance proposals rendered newly excludable

[10] Letter to the SEC from Heidi Welsh, Feb. 3, 2020, at https://www.sec.gov/comments/s7-23-19/s72319-6739078-207689.pdf, page 3. The analysis was confined to shareholder proposals raising social or environmental concerns, including some that also involved corporate governance (such as board diversity).
[11] Ibid., page 10. For a more granular breakdown on votes, see page 11 of the Welsh letter.

under the proposed thresholds were by far the most likely to receive substantially higher support in the following year than proposals on environmental and social matters. Fully, 20% of resubmitted newly excludable proposals related to governance received "substantially higher" support the following year (defined as doubled support or more than 25%), compared with 11% of resubmitted newly excludable proposals related to environmental issues and 7% of resubmitted newly excludable proposals related to social issues.

Conclusion

As discussed in CII's Jan. 30, 2020, letter to the SEC (cited above), for many reasons CII opposes the 14a-8 amendments. We do not believe the SEC proposal to further limit shareholder proposals, which are almost always nonbinding, should be implemented at a time when investors increasingly are seeking to integrate ESG factors into investment. Notwithstanding a strong surge of interest in ESG, the number of shareholder proposals has remained relatively low, and evidence is lacking that the SEC should further constrain these proposals.

The analysis in this report finds that the SEC rule changes on resubmissions would have a significant impact on several areas of concern for a wide range of CII members. The impact from other elements of the proposed SEC amendments have not been explored with any degree of rigor by the SEC and are reasons for further concern. The proposed amendments would not just stymie the voices of highly-engaged investors; they would impede the ability of management and boards to gauge and respond to the collective voice of their shareholders on emerging issues affecting long-term company performance.

Appendix A

Appendix A shows the specific proposals would have been eligible for resubmission under the existing 3/6/10 thresholds but would fail to satisfy the proposed 5/15/25 thresholds or the proposed rule's new momentum requirement. The table includes the company, proposal, ESG classification, the effect of the proposed rule, and what actually happened in the context of the existing rule. Proposals highlighted in yellow are at companies with multiple share classes that have differential voting rights. Proposals highlighted in green would have been stopped by the SEC's proposed "momentum rule."

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
3M	No Corporate Spending in Elections	S	Stopped at Year 2 with 6.2% of vote	Not in following year proxy
Abbott Laboratories	Label GMO Ingredients	E	Stopped at Year 1 with 3.2% of vote	Stopped at Year 3 with 5.6% of vote
Abbott Laboratories	Require Independent Board Chair	G	Stopped by Momentum Rule after 2018 vote	Received 19.9% of vote in 2019 and up for vote in 2020
AbbVie	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 24.3% of vote	Received 24.7% of vote in 2019
Advance Auto Parts	Provide Right to Act by Written Consent	G	Stopped at Year 5 with 11.1% of vote	Received 11.1% of vote in 2019
Allstate	Report on Political Contributions	S	Stopped at Year 3 with 11.1% of vote	Received 46.6% of vote in 2019
Allstate	Report on Lobbying Payments and Policies	S	Stopped at Year 2 with 10.3% of vote	Not in following year proxy
Alphabet	Adopt One Share, One Vote	G	Stopped at Year 3 with 23.7% of vote	Received 30% of vote in 2019
Alphabet	Report on Lobbying Payments and Policies	S	Stopped at Year 2 with 9.6% of vote	Stopped at 2018 with 9.4% of vote
Alphabet	Require Independent Board Chair	G	Stopped at Year 3 with 13.4% of vote	Not in following year proxy
Alphabet	Report on Gender Pay Gap	S	Stopped at Year 2 with 12.7% of vote	Received 11.1% of vote in 2019
Alphabet	Report on Political Contributions	S	Stopped at Year 2 with 10.2% of vote	Not in following year proxy
Alphabet	Incorporate Sustainability in Compensation	E	Stopped at Year 2 with 9.0% of vote	Received 9.0% of vote in 2019
Altria Group	Inform on Consequences of Tobacco	S	Stopped at Year 1 with 3.2% of vote	Not in following year proxy
Amazon	Report on Political Contributions	S	Stopped at Year 3 with 22.9% of vote	Stopped in Year 4 with 5.5% of vote
Amazon	Incorporate Sustainability in Compensation	E	Stopped at Year 1 with 4.9% of vote	Not in following year proxy

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
Amazon	Exclude Abstentions in Vote Counting	G	Stopped at Year 2 with 7.8% of vote	Not in following year proxy
Ameren	Report on Coal Combustion Waste	E	Stopped at Year 2 with 10.8% of vote	Not in following year proxy
Ameren	Report on Renewable Energy	E	Stopped at Year 2 with 11.1% of vote	Stopped at Year 4 with 9.2% of vote
American Express	Require Independent Board Chair	G	Stopped at Year 3 with 15.8% of vote	Voted on and supported by 21.4% in 2019
American Express	Report on Oversight of Data and Privacy	G	Stopped at Year 3 with 22.0% of vote	Not in following year proxy
American Express	Report on Employment Diversity	S	Stopped at Year 3 with 24.3% of vote	Not in following year proxy
Amgen	Exclude Abstentions in Vote Counting	G	Stopped at Year 2 with 6.2% of vote	Not in following year proxy
Anadarko Petroleum	Report on Political Contributions	S	Stopped at Year 2 with 20.3% of vote	Received 20.4% of vote in Year 3
Anthem	Report on Lobbying Payments and Policies	S	Stopped at Year 2 with 13.4% of vote	Stopped at Year 3 with 9.4% of vote
Apple	Adopt Proxy Access	G	Stopped at Year 1 with 4.3% of vote	Received 29.5% of vote in 2019
Aqua America	Report on Human Right of Water	S	Stopped at Year 2 with 10.1% of vote	Stopped at Year 4 with 5.6% of vote
AT&T	Report on Political Contributions	S	Stopped at Year 3 with 24.6% of vote	Received 30.0% support in 2017
AT&T	Require Independent Board Chair	G	Stopped at Year 3 with 23.8% of vote	Received 40.5% vote in 2019 and 40.2% in 2020
AutoNation	Require Independent Board Chair	G	Stopped at Year 3 with 23.8% of vote	Stopped in Year 5 with 5.2% of vote
Avon Products	Report on Substitutes for Ingredients	E	Stopped at Year 2 with 14.3% of vote	Not in following year proxy
Baker Hughes	Exclude Abstentions in Vote Counting	G	Stopped at Year 2 with 14.6% of vote	Not in following year proxy
Bank of America	Disclose Prior Government Service	G	Stopped at Year 1 with 4.6% of vote	Not in following year proxy
Bank of America	Amend Clawback Policy	G	Stopped at Year 2 with 6.4% of vote	Stopped at Year 3 with 5.8% of vote
Bank of America	No Corporate Spending in Elections	S	Stopped at Year 1 with 4.6% of vote	Not in following year proxy
Bank of America	Adopt Proxy Access	G	Stopped at Year 2 with 6.5% of vote	Received 26% of vote in 2019
Bank of America	Report on Climate Change Finance Risk	E	Stopped at Year 2 with 8.8% of vote	Not in following year proxy
Bank of America	Non-Core Banking Operations	G	Stopped at Year 1 with 4.5% of vote	Not in following year proxy

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
Bank of New York Mellon	Report on Climate Change Policies	E	Stopped at Year 2 with 6.8% of vote	Not in following year proxy
BB&T	Report on Political Contributions	E	Stopped by Momentum Rule after 2015 vote	Not in following year proxy
Berkshire Hathaway	Adopt Quantitative Goals on Emissions	E	Stopped at Year 2 with 8.6% of vote	Stopped at Year 3 with 8.8% of vote
BlackRock	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 21.0% of vote	Received 21.7% of vote in 2019
BlackRock	Report on Proxy Voting and Compensation	G	Stopped at Year 1 with 4.4% of vote	Not in following year proxy
Boeing	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 20.6% of vote	Received 32.6% of vote in 2019
Boeing	Require Independent Board Chair	G	Stopped by Momentum Rule after 2018 vote	Received 34.8% of vote in 2019 and 52.9% in 2020
Boston Scientific	Report on Animal Testing	S	Stopped at Year 1 with 4.6% of vote	Not in following year proxy
Caterpillar	Report on Political Contributions	S	Stopped at Year 2 with 10.4% of vote	Not in following year proxy
Charles Schwab	Report on Employment Diversity	S	Stopped at Year 3 with 24.3% of vote	Received 35.8% of vote in 2018
Charles Schwab	Exclude Abstentions in Vote Counting	G	Stopped at Year 1 with 4.6% of vote	Not in following year proxy
Charles Schwab	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 24.2% of vote	Not in following year proxy
Chemours	Report on Pay Disparity	S	Stopped at Year 1 with 4.9% of vote	Stopped at Year 2 with 4.2% of vote
Chesapeake Energy	Establish Risk Oversight Committee	G	Stopped at Year 1 with 4.0% of vote	Stopped at Year 2 with 2.4% of vote
Chevron	Report on Offshore Oil Spill Mitigation	E	Stopped at Year 2 with 7.3% of vote	Not in following year proxy
Chevron	Report on Climate Change Finance Risk	E	Stopped at Year 2 with 7.6% of vote	Not in following year proxy
Chevron	Require Director Environmental Experience	E	Stopped at Year 3 with 21.7% of vote	Received 26.5% of vote in 2019
Chevron	Report on Country Selection Guidelines	S	Stopped at Year 3 with 22.0% of vote	Not in following year proxy
Chevron	Require Independent Board Chair	G	Stopped at Year 3 with 21.5% of vote	Received 23% of vote in 2019
Chevron	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 24.1% of vote	Received 31.5% of vote in 2018
Chevron	Increase Return of Capital for Climate Change	E	Stopped at Year 1 with 3.2% of vote	Stopped at Year 2 with 3.5% of vote
Chevron	Adopt Quantitative Goals on Emissions	E	Stopped at Year 2 with 7.9% of vote	Not in following year proxy

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
Chevron	Report on Transition to Low Carbon Model	E	Stopped at Year 2 with 8.1% of vote	Received 33.2% of vote in 2019
Chevron	Report on Risks of Business in Conflict Areas	S	Stopped at Year 2 with 7.3% of vote	Not in following year proxy
Chevron	Report on Effects of Fracking	E	Stopped by Momentum Rule after 2014 vote	Received 30.7% of vote in 2016
Chevron	Shareholders May Call Special Meeting	G	Stopped by Momentum Rule after 2015 vote	Received 35.9% of vote in 2017
Citigroup	Report on Political Contributions	S	Stopped at Year 2 with 10.2% of vote	Not in following year proxy
Citigroup	Audit Oversight of Loan Policies	G	Stopped at Year 2 with 14.3% of vote	Not in following year proxy
Citigroup	Review Director Indemnification Policy	G	Stopped at Year 1 with 3.3% of vote	Stopped at Year 2 with 2.4% of vote
Citigroup	Appoint Stockholder Value Committee	G	Stopped at Year 1 with 3.6% of vote	Stopped at Year 2 with 2.6% of vote
CNX Resources	Report on Political Contributions	S	Stopped at Year 3 with 21.6% of vote	Not in following year proxy
CoBiz Financial	Require Independent Board Chair	G	Stopped at Year 4 with 23.1% of vote	Not in following year proxy
Comcast	Require Independent Board Chair	G	Stopped at Year 3 with 23.3% of vote	Received 26.9% of vote in 2019
Comcast	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 16.7% of vote	Received 18.0% of vote in 2019
Conagra Brands	Exclude Abstentions in Vote Counting	G	Stopped at Year 2 with 12.6% of vote	Not in following year proxy
ConocoPhillips	Address Coastal Environmental Impacts	E	Stopped at Year 2 with 6.3% of vote	Not in following year proxy
ConocoPhillips	Report on Lobbying Payments and Policies	S	Stopped at Year 4 with 24.8% of vote	Received 23.9% of vote in 2017
ConocoPhillips	Cease Using Oil Reserves in Compensation	E	Stopped at Year 2 with 3.9% of vote	Not in following year proxy
ConocoPhillips	Adopt Quantitative Goals on Emissions	E	Stopped by Momentum Rule after 2014 vote	Not in following year proxy
Consolidated Edison	Disclose Compensation over $500,000	G	Stopped at Year 2 with 10.6% of vote	Not in following year proxy
Continental Resources	Adopt a Policy on Board Diversity	S	Stopped at Year 2 with 10.0% of vote	Not in following year proxy
CVS Health	Report on Values and Political Donations	S	Stopped at Year 2 with 6.5% of vote	Not in following year proxy
CVS Health	Report on Gender Pay Gap	S	Stopped at Year 2 with 7.4% of vote	Not in following year proxy
Darden Restaurants	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 23.7% of vote	Not in following year proxy

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
Darden Restaurants	Phase Out Non-Therapeutic Antibiotics	E	Stopped at Year 2 with 12.8% of vote	Not in following year proxy
DaVita	Provide Right to Act by Written Consent	G	Stopped at Year 2 with 14.1% of vote	Not in following year proxy
Dean Foods	Require Independent Board Chair	G	Stopped at Year 2 with 8.9% of vote	Not in following year proxy
Devon Energy	Cease Using Oil Reserves in Compensation	E	Stopped at Year 2 with 6.9% of vote	Not in following year proxy
DISH Network	Adopt One Share, One Vote	G	Stopped at Year 1 with 4.3% of vote	Not in following year proxy
Dominion Energy	Report on Nuclear Plant Risk	E	Stopped at Year 1 with 4.1% of vote	Received 17.6% of vote in Year 2
Dominion Energy	Report on Reducing Coal Risk	E	Stopped at Year 2 with 9.5% of vote	Stopped at Year 3 with 6.9% of vote
Dominion Energy	Report on Climate Change Finance Risk	E	Stopped at Year 3 with 23.6% of vote	Not in following year proxy
Dominion Energy	Report on Lobbying Payments and Policies	S	Stopped at Year 2 with 11.3% of vote	Stopped at Year 3 with 7.3% of vote
Dominion Energy	Report on Methane Emissions	E	Stopped at Year 3 with 23.7% of vote	Not in following year proxy
Duke Energy	Report on Reducing Coal Risk	E	Stopped at Year 2 with 12.0% of vote	Received 40.9% of vote in 2019
Ecolab	Require Independent Board Chair	G	Stopped at Year 3 with 21.2% of vote	Received 21.2% of vote in 2019
Edwards Lifesciences	Provide Right to Act by Written Consent	G	Stopped at Year 3 with 23.8% of vote	Not in following year proxy
Eli Lilly	Report on Animal Testing	S	Stopped at Year 1 with 3.2% of vote	Not in following year proxy
Expedia	Report on Political Contributions	S	Stopped at Year 2 with 13.8% of vote	Not in following year proxy
Exxon Mobil	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 24.9% of vote	Received 26.3% of vote in 2018
Exxon Mobil	Adopt Anti-Bias Sexual Orientation Policy	S	Stopped at Year 3 with 19.8% of vote	Not in following year proxy
Exxon Mobil	Report on Effects of Fracking	E	Stopped at Year 3 with 24.9% of vote	Received 25.0% of vote in 2019
Exxon Mobil	Adopt Quantitative Goals on Emissions	E	Stopped at Year 3 with 23.0% of vote	Stopped at Year 4 with 9.0% of vote
Exxon Mobil	Disclose Female Compensation	S	Stopped at Year 2 with 8.5% of vote	Stopped at Year 3 with 7.9% of vote
Exxon Mobil	Increase Return of Capital for Climate Change	E	Stopped at Year 1 with 4.6% of vote	Stopped at Year 2 with 3.8% of vote
Facebook	Report on Sustainability	E	Stopped at Year 2 with 8.4% of vote	Stopped at Year 3 with 8.8% of vote

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
Facebook	Report on Lobbying Payments and Policies	S	Stopped at Year 2 with 8.3% of vote	Stopped at Year 3 with 9.4% of vote
Facebook	Adopt One Share, One Vote	G	Stopped at Year 3 with 16.0% of vote	Received 24.5% of vote in 2019
Facebook	Report on Gender Pay Gap	S	Stopped at Year 2 with 7.4% of vote	Stopped at Year 4 with 9.9% of vote
FedEx	Report on Values and Political Donations	S	Stopped at Year 1 with 4.0% of vote	Stopped at Year 2 with 4.0% of vote
FedEx	Exclude Abstentions in Vote Counting	G	Stopped at Year 2 with 8.1% of vote	Stopped at Year 3 with 5.9% of vote
FedEx	Report on Nondiscrimination Policies	S	Stopped at Year 1 with 4.6% of vote	Stopped at Year 2 with 2.0% of vote
First Citizens BancShares	Adopt One Share, One Vote	G	Stopped at Year 3 with 20.2% of vote	Not in following year proxy
FirstEnergy	Report on Reducing Coal Risk	E	Stopped after Year 2 with 11.4% of vote	Not in following year proxy
Ford Motor	Report on Political Contributions	S	Stopped at Year 1 with 4.2% of vote	Not in following year proxy
Ford Motor	Shareholders May Call Special Meeting	G	Stopped at Year 2 with 19.6% of vote	Not in following year proxy
Ford Motor	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 16.4% of vote	Received 16.4% of vote in 2019
Franklin Resources	No Investment in Genocide and Crimes	S	Stopped at Year 2 with 6.0% of vote	Not in following year proxy
Franklin Resources	Review Advocacy on Climate Change	E	Stopped at Year 1 with 4.5% of vote	Stopped at Year 2 with 4.5% of vote
General Dynamics	Require Independent Board Chair	G	Stopped at Year 3 with 14.0% of vote	Not in following year proxy
General Electric	Provide for Cumulative Voting	G	Stopped at Year 2 with 11.3% of vote	Stopped at Year 4 with 6.0% of vote
General Electric	Require Independent Board Chair	G	Stopped at Year 3 with 23.23% of vote	Received 28.4% of vote in 2019
General Electric	Provide Right to Act by Written Consent	G	Stopped at Year 3 with 21.0% of vote	Not in following year proxy
General Electric	Require More Nominees than Directorships	G	Stopped at Year 1 with 3.8% of vote	Stopped at Year 2 with 3.2% of vote
General Electric	Cease all Stock Options and Bonuses	G	Stopped at Year 1 with 4.4% of vote	Stopped at Year 2 with 3.7% of vote
General Electric	Adopt Holy Land Principles	S	Stopped at Year 1 with 3.2% of vote	Stopped at Year 2 with 3.6% of vote
General Electric	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 21.2% of vote	Not in following year proxy
General Motors	Require Independent Board Chair	G	Stopped by Momentum Rule after 2018 vote	Received 37.0% of vote in 2019

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
Goldman Sachs Group	Report on Lobbying Payments and Policies	S	Stopped at Year 2 with 6.3% of vote	Stopped at Year 3 with 9.0% of vote
Guess?	Submit Severance to Shareholder Vote	G	Stopped by Momentum Rule after 2019 vote	Received 26.4% of vote in 2019
Home Depot	Adopt Policy on Water Quality Stewardship	E	Stopped at Year 1 with 3.6% of vote	Stopped at Year 1 with 4.4% of vote
Home Depot	Report on Employment Diversity	S	Stopped by Momentum Rule after 2019 vote	Up for a vote in 2020
Honeywell International	Require Independent Board Chair	G	Stopped at Year 4 with 16.7% of vote	Not in following year proxy
HP	Establish Human Rights Board Committee	S	Stopped at Year 1 with 3.6% of vote	Stopped at Year 2 with 4.3% of vote
Ingles Markets	Adopt One Share, One Vote	G	Stopped at Year 2 with 12.4% of vote	Received 12.6% of vote in 2019
Intel	Adopt Holy Land Principles	S	Stopped at Year 1 with 3.2% of vote	Stopped at Year 2 with 3.9% of vote
Intel	Exclude Abstentions in Vote Counting	G	Stopped at Year 2 with 10.1% of vote	Not in following year proxy
Intel	Report on Political Contributions	S	Stopped at Year 2 with 6.9% vote	Stopped in Year 3 with 5.9% of vote
International Business Machines	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 24.5% of vote	Received 32.9% of vote in 2018
International Business Machines	Report on Political Contributions	S	Stopped at Year 2 with 9.7% of vote	Not in following year proxy
Interpublic Group	Require Independent Board Chair	G	Stopped at Year 3 with 21.2% of vote	Received 21.2% of vote in 2019
ITT	Improve Human Rights Policies	S	Stopped at Year 2 with 7.3% of vote	Not in following year proxy
Johnson & Johnson	End of Unnecessary Animal Testing	S	Stopped at Year 1 with 4.8% of vote	Stopped at Year 2 with 4.4% of vote
JPMorgan Chase	No Investment in Genocide and Crimes	S	Stopped at Year 2 with 10.7% of vote	Stopped at Year 3 with 9.6% of vote
JPMorgan Chase	Report on Political Contributions	S	Stopped at Year 2 with 10.6% of vote	Not in following year proxy
JPMorgan Chase	Stock Retention/Holding Period	G	Stopped at Year 2 with 8.3% of vote	Not in following year proxy
JPMorgan Chase	Report on Lobbying Payments and Policies	S	Stopped at Year 2 with 7.6% of vote	Stopped at Year 3 with 6.7% of vote
JPMorgan Chase	Provide for Cumulative Voting	G	Stopped at Year 3 with 10.0% of vote	Not in following year proxy
JPMorgan Chase	Exclude Abstentions in Vote Counting	G	Stopped at Year 2 with 7.8% of vote	Stopped at Year 3 with 8.6% of vote
JPMorgan Chase	Amend Clawback Policy	G	Stopped in Year 1 with 4.6% of vote	Stopped at Year 2 with 3.9% of vote

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
KeyCorp	Require Independent Board Chair	G	Stopped in Year 3 with 23.7% of vote	Received 24.2% of vote in 2017
Kohl's	Provide Right to Act by Written Consent	G	Stopped in Year 2 with 11.7% of vote	Not in following year proxy
Kohl's	Adopt Animal Cruelty Prevention Policy	S	Stopped at Year 1 with 3.3% of vote	Stopped at Year 2 with 3.0% of vote
Kraft Heinz	Report on Unrecyclable Packaging	E	Stopped at Year 3 with 13.5% of vote	Not in following year proxy
Kraft Heinz	Report on Extended Producer Responsibility	G	Stopped at Year 3 with 12.7% of vote	Not in following year proxy
Kroger	Report on Human Rights Risks	S	Stopped at Year 3 with 24.9% of vote	Not in following year proxy
Kroger	Report on Unrecyclable Packaging	E	Stopped at Year 3 with 24.0% of vote	Received 38.9% of vote in 2019
Lennar	Adopt Quantitative Goals on Emissions	E	Stopped at Year 2 with 11.3% of vote	Not in following year proxy
Lockheed Martin	Report on Lobbying Payments and Policies	S	Stopped in Year 2 with 6.5% of vote	Not in following year proxy
Marathon Petroleum	Adopt Quantitative Goals on Emissions	E	Stopped at Year 3 with 15.2% of vote	Not in following year proxy
Mattel	Require Independent Board Chair	G	Stopped by Momentum Rule after 2016 vote	Received 29.4% of vote in 2019
McDonald's	Report on Fast Food and Child Health	E	Stopped at Year 2 with 8.5% of vote	Stopped at Year 3 with 8.2% of vote
McDonald's	Report on Values and Political Donations	S	Stopped at Year 2 with 6.4% of vote	Not in following year proxy
McDonald's	Adopt Holy Land Principles	S	Stopped at Year 1 with 3.6% of vote	Stopped at Year 2 with 2.8% of vote
McDonald's	Exclude Abstentions in Vote Counting	G	Stopped at Year 2 with 9.4% of vote	Not in following year proxy
McDonald's	Report on Charitable Contributions	S	Stopped at Year 1 with 3.7% of vote	Stopped at Year 2 with 3.2% of vote
Merck	Report on Political Contributions	S	Stopped at Year 1 with 4.1% of vote	Stopped at Year 2 with 3.8% of vote
MGE Energy	Report on Electrification of Transportation	E	Stopped at Year 2 with 9.9% of vote	Not in following year proxy
Mondelez International	Reduce Deforestation in Supply Chain	E	Stopped at Year 2 with 11.4% of vote	Not in following year proxy
Mondelez International	Report on Plant Closures	S	Stopped at Year 2 with 6.1% of vote	Not in following year proxy
Morgan Stanley	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 6.4% of vote	Not in following year proxy
Morgan Stanley	Exclude Abstentions in Vote Counting	G	Stopped at Year 1 with 4.6% of vote	Stopped at Year 3 with 7.6% of vote

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
Morgan Stanley	Pro-Rata Vesting of Equity Awards	G	Stopped at Year 3 with 20.0% of vote	Not in following year proxy
Motorola Solutions	Improve Human Rights Policies	S	Stopped at Year 2 with 6.3% of vote	Not in following year proxy
Motorola Solutions	Report on Sustainability	E	Stopped at Year 2 with 6.1% of vote	Not in following year proxy
Motorola Solutions	Report on Human Rights in Supply Chain	S	Stopped at Year 2 with 13.1% of vote	Not in following year proxy
Motorola Solutions	Require Director Human Rights Experience	S	Stopped at Year 2 with 8.2% of vote	Not in following year proxy
Nasdaq	Provide Right to Act by Written Consent	G	Stopped by Momentum Rule after 2019 vote	Up for a vote in 2020
Netflix	Adopt Proxy Access	G	Stopped at Year 1 with 4.0% of vote	Received 71.8% of vote in 2018
Northern Trust	Report on Political Contributions	S	Stopped at Year 3 with 24.0% of vote	Received 25.3% of vote in 2019
Northrop Grumman	Require Independent Board Chair	G	Stopped at Year 3 with 22.8% of vote	Received 35.5% of vote in 2019
Occidental Petroleum	Report on Political Contributions	S	Stopped at Year 2 with 7.9% of vote	Not in following year proxy
Omnicom Group	Require Independent Board Chair	G	Stopped at Year 3 with 23.0% of vote	Received 23.0% of vote in 2019
Oracle	Exclude Abstentions in Vote Counting	G	Stopped at Year 2 with 8.5% of vote	Not in following year proxy
PayPal Holdings	Report on Political Contributions	S	Stopped at Year 2 with 8.3% of vote	Not in following year proxy
PepsiCo	Establish Committee on Sustainability	E	Stopped at Year 1 with 4.6% of vote	Not in following year proxy
PepsiCo	Minimize Pesticides' Impact on Pollinators	E	Stopped at Year 2 with 8.9% of vote	Received 10.8% of vote in 2019
PepsiCo	Adopt Holy Land Principles	S	Stopped at Year 1 with 3.9% of vote	Stopped at Year 2 with 3.2% of vote
Pfizer	Publish Political Contributions in Newspapers	S	Stopped at Year 1 with 4.6% of vote	Stopped at Year 2 with 4.2% of vote
Pfizer	Provide Right to Act by Written Consent	G	Stopped at Year 3 with 12.4% of vote	Received 12.4% of vote in 2019
Pilgrim's Pride	Adopt Policy on Water Quality Stewardship	E	Stopped at Year 2 with 6.6% of vote	Not in following year proxy
PNM Resources	Require Independent Board Chair	G	Stopped at Year 2 with 12.8% of vote	Not in following year proxy
PNM Resources	Assess Impact of 2 Degree Scenario	E	Stopped at Year 2 with 14.5% of vote	Not in following year proxy
Procter & Gamble	Shareholder Approval of Contributions	S	Stopped at Year 2 with 7.8% of vote	Not in following year proxy

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
Procter & Gamble	Report on Values and Political Donations	S	Stopped at Year 2 with 7.3% of vote	Not in following year proxy
Procter & Gamble	Report on Nondiscrimination Policies	S	Stopped at Year 2 with 8.7% of vote	Not in following year proxy
Prudential Financial	Provide Right to Act by Written Consent	G	Stopped at Year 2 with 13.6% of vote	Not in following year proxy
PulteGroup	Award Performance Stock Options	G	Stopped by Momentum Rule after 2014 vote	Received 28.7% of vote in 2015
Reliance Steel & Aluminum	Require Independent Board Chair	G	Stopped at Year 3 with 24.6% of vote	Not in following year proxy
Republic Services	Report on Political Contributions	S	Stopped at Year 3 with 18.9% of vote	Received 22.4% of vote in 2019
Rite Aid	No Related Party Transactions	G	Stopped at Year 1 with 3.2% of vote	Stopped at Year 2 with 3.9% of vote
RPC	Report on Sustainability	E	Stopped at Year 2 with 6.8% of vote	Not in following year proxy
S&P Global	Provide Right to Act by Written Consent	G	Stopped by Momentum Rule after 2019 vote	Not in following year proxy
Santander Consumer USA	Report on Vehicle Lending Risk	S	Stopped at Year 2 with 11.3% of vote	Not in following year proxy
Seaboard	Report on Political Contributions	S	Stopped at Year 1 with 4.8% of vote	Stopped at Year 2 with 3.8% of vote
Sempra Energy	Incorporate Sustainability in Compensation	E	Stopped at Year 2 with 6.1% of vote	Not in following year proxy
Sempra Energy	Require Independent Board Chair	G	Stopped at Year 3 2ith 16.3% of vote	Not in following year proxy
Sketchers U.S.A.	Report on Board Diversity	S	Stopped at Year 3 with 11.3% of vote	Received 26.6% of vote in 2019
Starbucks	Establish Committee on Sustainability	E	Stopped at Year 1 with 4.5% of vote	Stopped at Year 2 with 4.8% of vote
Starbucks	No Corporate Spending in Elections	S	Stopped at Year 1 with 3.8% of vote	Stopped at Year 2 with 2.2% of vote
T. Rowe Price Group	Report on Climate Change Policies	E	Stopped at Year 2 with 9.0% of vote	Not in following year proxy
Tapestry	Create Plan for Zero Emissions	E	Stopped at Year 2 with 8.3% of vote	Not in following year proxy
Target	Report on Electronics Recycling	E	Stopped at Year 2 with 8.6% of vote	Stopped at Year 3 with 9.7% of vote
Target	Require Independent Board Chair	G	Stopped by Momentum Rule after 2018 vote	Not in following year proxy
Telephone and Data Systems	Adopt One Share, One Vote	G	Stopped by Momentum Rule after 2018 vote	Received 35.5% of vote in 2019
The Kraft Heinz Company	Reduce Deforestation in Supply Chain	E	Stopped at Year 2 with 13.1% of vote	Not in following year proxy

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
TJX	Report on Gender Pay Gap	S	Stopped at Year 3 with 18.4% of vote	Received 18.9% of vote in 2019
T-Mobile USA	Adopt Proxy Access	G	Stopped at Year 3 with 19.9% of vote	Received 22.8% of vote in 2018
T-Mobile USA	Pro-Rata Vesting of Equity Awards	G	Stopped at Year 3 with 12.7% of vote	Received 10.6% of vote in 2019
T-Mobile USA	Clawback Incentive Payments	G	Stopped at Year 2 with 7.8% of vote	Not in following year proxy
Tysons Foods	Adopt Policy on Water Quality Stewardship	E	Stopped at Year 3 with 14.7% of vote	Received 15.8% of vote in 2018
Tysons Foods	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 12.0% of vote	Received 11.2% of vote in 2019
U.S. Bancorp	Require Independent Board Chair	G	Stopped at Year 3 with 16.3% of vote	Received 31.9% of vote in 2017
UMB Financial	Require Independent Board Chair	G	Stopped at Year 3 with 24.8% of vote	Received 22.5% of vote in 2017
Union Pacific	Require Independent Board Chair	G	Stopped at Year 4 with 13.4% of vote	Received 13.4% of vote in 2019
Union Pacific	Stock Retention/Holding Period	G	Stopped at Year 3 with 24.4% of vote	Stopped at Year 4 with 4.9% of vote
United Parcel Service	Report on Lobbying Payments and Policies	S	Stopped at Year 2 with 11.7% of vote	Received 20.0% of vote in 2019
United Parcel Service	Adopt One Share, One Vote	G	Stopped at Year 3 with 24.9% of vote	Received 28.0% of vote in 2019
UnitedHealth Group	Report on Lobbying Payments and Policies	S	Stopped at Year 3 with 24.4% of vote	Not in following year proxy
Universal Health Services	Adopt Proxy Access	G	Stopped at Year 2 with 8.3% of vote	Stopped at Year 3 with 8.6% of vote
Verizon Communications	Disclose Prior Government Service	S	Stopped at Year 2 with 10.5% of vote	Not in following year proxy
Verizon Communications	Report on Net Neutrality	S	Stopped at Year 3 with 23.2% of vote	Not in following year proxy
Verizon Communications	Stock Retention/Holding Period	G	Stopped at Year 2 with 7.3% of vote	Not in following year proxy
Verizon Communications	Incorporate Cybersecurity in Compensation	S	Stopped at Year 2 with 12.4% of vote	Received 12.4% of vote in 2019
Voya Financial	No Investment in Genocide and Crimes	S	Stopped at Year 1 with 4.5% of vote	Stopped at Year 3 with 7.5% of vote
Walgreens Boots Alliance	Stock Retention/Holding Period	G	Stopped at Year 3 with 17.8% of vote	Not in following year proxy
Walmart	Disclose Senior Executive Recoupment	G	Stopped at Year 3 with 15.6% of vote	Not in following year proxy
Walmart	Require Independent Board Chair	G	Stopped at Year 3 with 16.2% of vote	Received 16.1% of vote in 2018

Company	Proposal	ESG	Under Proposed Rule, Resolutions on This Issue Would Have Been:	Under Existing Rule: What Happened?
Walmart	Report on Incentive Compensation Plans	G	Stopped at Year 2 with 9.6% of vote	Not in following year proxy
Wells Fargo	Audit Oversight of Loan Policies	G	Stopped at Year 2 with 6.4% of vote	Not in following year proxy
Wells Fargo	Require Independent Board Chair	G	Stopped at Year 3 with 22.0% of vote	Received 17.2% of vote in 2016
Wells Fargo	Report on Lobbying Payments and Policies	S	Stopped at Year 2 with 11.0% of vote	Stopped at Year 3 with 8.0% of vote
Western Union	Establish Human Rights Board Committee	S	Stopped at Year 2 with 12.0% of vote	Stopped at Year 3 with 3.2% of vote
Western Union	Report on Political Contributions	S	Stopped by Momentum Rule after 2017 vote	Received 43.2% of vote in 2019
Wyndham Destinations	Report on Political Contributions	S	Stopped by Momentum Rule after 2019 vote	Not in following year proxy
Wynn Resorts	Report on Political Contributions	S	Stopped at Year 3 with 14.6% of vote	Received 34.4% of vote in 2019
Xcel Energy	Require Independent Board Chair	G	Stopped at Year 3 with 22.1% of vote	Received 18.9% of vote in 2017
Zions Bancorporation	Require Independent Board Chair	G	Stopped at Year 3 with 15.8% of vote	Received 23.8% of vote in 2017

Credit Union National Association
CUNA

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June 25, 2020

The Honorable Brad Sherman
Chairman
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Bill Huizenga
Ranking Member
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Sherman and Ranking Member Huizenga:

On behalf of America's credit unions, I am writing regarding the hearing entitled, "Capital Markets and Emergency Lending in the COVID-19 Era." The Credit Union National Association (CUNA) represents America's credit unions and their 115 million members.

Ensuring that consumers are protected during and after the COVID-19 pandemic is paramount for credit unions. We applaud Congressional efforts to establish the Paycheck Protection Program (PPP) created by the CARES Act. Thanks to the PPP, credit unions have been able to help their members by providing loans to many small businesses in need across the United States during these challenging times.

H.R. 6790, The Business Borrowers Protection Act

H.R. 6790 would prevent lenders from requiring borrowers to repay on an accelerated basis any government loan related to the COVID-19 pandemic. We thank Chairman Sherman for his efforts to protect consumers and small businesses. However, we believe that this legislation would be unnecessary if a simplified loan forgiveness policy was in place.

The linchpin of PPP is loan forgiveness. This unique feature effectively turns a PPP loan into a grant if specific conditions are met for the use of the borrowed funds. Loan forgiveness helps support businesses by providing them funding to pay employees and certain other expenses that will not have to be repaid, allowing businesses to stay solvent in a time of decreased revenues. The size and sophistication of borrowers varies widely from large public corporations to the self-employed. In fact, some credit unions made PPP loans to members for less than $1,000. Although borrower size and sophistication varies widely, we suspect that nearly all borrowers envision applying for and receiving forgiveness for these loans. Credit unions are concerned that the recently published application for loan forgiveness is overly complex for most businesses.

We ask Congress to ensure Treasury and the Small Business Administration (SBA) simplify the forgiveness application process for loans under $350,000. This threshold would capture the vast majority of loans and is the amount at which the CARES Act makes the lowest cutoff in determining lender processing fees. Additionally, the agencies should consider making forgiveness of these loans automatic or simply require a good faith certification that the funds were spent on forgivable expenses.

H.R. ____, The CARES Act Section 4014 Technical Corrections Act

A provision to delay the effective date of the Financial Accounting Standards Board's (FASB) Current Expected Credit Loss (CECL) accounting standard for entities presently required to comply with the standard was included in the CARES Act. However, this provision does not relieve the burden on credit unions and other lenders which have until 2023 to come into compliance. This legislation does correct a problem for certain financial institutions. However, we encourage Congress to ensure the relief from CECL in the CARES Act does not terminate in the middle of a company's fiscal year and recommend a further delay of CECL for credit unions and other lenders, which should have been included in the first place.

We appreciate FASB's decision in October 2019 to move the effective date for CECL compliance to January 2023 for credit unions and other financial institutions. At the time the FASB proposed moving the date, we supported 2023 as an appropriate timeframe for credit unions.

However, in light of the current crisis, we urge FASB and Congress to provide additional time for CECL compliance. While some credit unions are in the final stages of preparation, the vast majority are in the very early stages of gathering necessary data and beginning to make the numerous changes required under CECL. A one-year delay will help ensure our nation's credit unions—the median of which is well under $50 million in assets—are prepared to comply. Therefore, we urge the Committee to delay the effective date of CECL as it applies to credit unions until at least January 2024.

H.R. ___ To temporarily halt the Federal financial regulators from carrying out rulemakings unrelated to the COVID-19 emergency until the end of such emergency

While we appreciate the intent of this legislation—to temporarily halt regulators from carrying out rulemakings unrelated to the COVID-19 pandemic—we are concerned that the way this legislation is drafted may spur severe unintended consequences. This legislation would halt updates to important and timely rulemakings such as the CFPB's updates to its payday rule and even prevent the National Credit Union Administration from updating its rulemakings.

A more constructive approach would be to suspend all pending rulemakings - and not propose additional rulemakings – except those intended to reduce regulatory burden or to facilitate service to members during this crisis. We encourage Congress to consider this approach prospectively.

On behalf of America's credit unions and their 115 million members, thank you for considering our views.

Sincerely,

Jim Nussle
President & CEO

May 26, 2020

Hon. Jay Clayton
Chairman
Securities and Exchange Commission
100 F Street NE
Washington, DC 20002

Via electronic delivery

Re: Corporate Transparency and Accountability and the Coronavirus Pandemic
Comments on Selected Rulemakings (Appendix)

Dear Chairman Clayton:

America is in crisis. The raging coronavirus pandemic has infected more than 1.6 million Americans and killed nearly 100,000 to date.[1] The health crisis has also caused a unprecedented economic shutdown that threw more than 20 million Americans out of work in April alone.[2] Unemployment is predicted to remain above 10 percent through the end of 2021, long after social distancing measures have ended.[3] Making this crisis worse are the decades of economic and financial regulatory policies that have stripped workers and investors of information and rights, while allowing anti-competitive and abusive corporate practices to flourish.

The Securities and Exchange Commission (SEC or Commission) is operating in a profoundly different world than that which existed just a few months ago. However, rather than taking stock of how the world and capital markets have fundamentally changed since February, the Commission seems to be acting as if little has happened. This is a mistake.

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[1] The COVID Tracking Project, available at https://covidtracking.com/data/us-daily (last accessed May 25, 2020).
[2] Jerome H. Powell, Opening Remarks, At "A Fed Listens Event: How Is COVID-19 Affecting Your Community?," sponsored by the Board of Governors of the Federal Reserve System, Washington, D.C. (May 21, 2020), https://www.federalreserve.gov/newsevents/speech/powell20200521a.htm (noting this is "a downturn without modern precedent.").
[3] Phil Swagel, *CBO's Current Projections of Output, Employment, and Interest Rates and a Preliminary Look at Federal Deficits for 2020 and 2021*, Congressional Budget Office, Apr. 24, 2020, *available at* https://www.cbo.gov/publication/56335; see also Jacob Leibenluft and Andres Vinelli, "The Trump Administration's Handling of Coronavirus Threatens a Long Unemployment Crisis," Center for American Progress, May 7, 2020, *available at* https://www.americanprogress.org/issues/economy/news/2020/05/07/484795/trump-administrations-handling-coronavirus-threatens-long-unemployment-crisis/.

If anything, the extraordinary shocks and interventions arising from the coronavirus crisis have demonstrated that U.S. capital markets need more, not less market transparency and accountability. Investors and the public are demanding the ability to scrutinize corporations and their management, as they and other stakeholders rightly need to know which firms are receiving trillions of dollars of Federal support, how they are spending it, whether workers are getting the monies intended for the survival of their households, and whether companies remain susceptible to future waves of the pandemic, future lockdowns, and other economic shocks.[4]

Moreover, the pandemic makes it more difficult for the agency to solicit, and for interested parties to provide, input. This on its own justifies slowing down and freezing many rulemakings.[5] More importantly, the new circumstances that are still developing must be taken into account as the Commission and staff develop reforms. The epidemic is shaking every part of the capital markets to their core—many capital markets have frozen or required emergency government loans or liquidity, established businesses have sought emergency funding, and businesses from start-ups to public companies have shed businesses and terminated thousands of employees. Far more needs to be done to understand which capital markets are functioning, which are fundamentally unstable, and what regulatory remedies are required. The data simply does not support sweeping deregulation under these circumstances.

We urge the SEC to reverse course. Instead of undermining the working families and retirees whose investment nest egg has only shrunk further in recent weeks, the SEC should be taking regulatory actions to protect those workers and investors, promote sustainable corporate practices, and promote competition. This would include immediately taking action to promote corporate transparency, enhance investor rights, enforce the rule of law, and promote competition.

To achieve these objectives, the Commission should:

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[4] See Marc Jarsulic and Gregg Gelzinis, *Making the Fed Rescue Serve Everyone in the Aftermath of the Coronavirus Pandemic*, Center for American Progress, May 14, 2020, *available at* https://www.americanprogress.org/issues/economy/news/2020/05/14/484951/making-fed-rescue-serve-everyone-aftermath-coronavirus-pandemic/; Better Markets, *Better Markets Applauds Federal Reserve's Announced Commitment for CARES Act Program Transparency*, Apr. 23, 2020, *available at* https://bettermarkets.com/newsroom/better-markets-applauds-federal-reserve%E2%80%99s-announced-commitment-cares-act-program; Marc Jarsulic and David Madland, *Industry and Firm Bailouts Amid the Coronavirus Pandemic*, Center for American Progress, Mar. 18, 2020, *available at* https://www.americanprogress.org/issues/economy/news/2020/03/18/481945/industry-firm-bailouts-amid-coronavirus-pandemic/. On regulatory actions, see Better Markets, "Tracker of Regulatory Agencies Coronavirus Emergency Responses," *available at* https://www.bettermarkets-tracer.org/ (last accessed May 2020).

[5] This doubly goes for public interest groups, who cannot employ an army of lobbyists to address the never-ending series of matters emerging in this crisis as well as on-going "ordinary" rulemakings.

(1) Reduce—not expand—exemptions to public offering rules to ensure capital is allocated in brightly lit U.S. public markets;
(2) expand—not undermine—disclosures that protect investors, workers, taxpayers, and other corporate stakeholders; and
(3) lower—not raise—barriers to the exercise of corporate suffrage.

Background and the Importance of Disclosure and Accountability in the Public Markets

For decades, the federal securities laws ensured that investors had essential information about the companies in which they might invest, as well as the power to take actions based on what they learned. The justification was simple: as the Commission explains on its website:

> Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions.
>
> The result of this information flow is a far more active, efficient, and transparent capital market that facilitates the capital formation so important to our nation's economy.[6]

We agree.[7] Congress came to the same conclusion nearly 90 years ago, when it adopted the federal securities laws.

> Whatever may be the full catalogue of the forces that brought to pass the present depression, not least among these has been this wanton misdirection of the capital resources of the Nation ... The bill closes the channels of such commerce to security issuers unless and until a full disclosure of the character of such securities has been made.[8]

Unfortunately, this bedrock principle underpinning the securities laws and the Commission's own existence is under attack. Sweeping deregulation has resulted in companies no longer needing to tell the public basic information about themselves in order to raise billions of dollars. From the 1930s through the 1970s, strict Commission rules required nearly all offerings of securities to be registered. Beginning in the early 1980s, however, holes began to be poked in this regime. Those holes—the exemptions and exceptions—have now overwhelmed the

[6] U.S. Securities & Exchange Commission, What We Do, *available at* https://www.sec.gov/Article/whatwedo.html.
[7] See, e.g., Letter from Tyler Gellasch, Healthy Markets Association, to Vanessa Countryman, SEC, Sept. 30, 2019, *available at* https://healthymarkets.org/wp-content/uploads/2019/09/SEC-Concept-Release-9-30-19-1.pdf; see also Andy Green, *Opinion: Could the SEC secretly abolish investors' right to sue?*, MarketWatch, Mar. 2, 2019, *available at* https://www.marketwatch.com/story/could-the-sec-secretly-abolish-investors-right-to-sue-2018-03-02#false.
[8] H. Rep. 73-85 (1933), at 2-3.

general rule. In fact, by 2019, nearly 70 percent of capital was raised outside of the SEC's public registration and disclosure regime.[9] To put it mildly, the "channels of commerce" are clearly not "closed" to companies selling securities without "full disclosure."

To the contrary, along with unprecedented volumes of exempt offerings, we've seen a slew of "private" trading venues emerge,[10] some of which extract enormous costs from investors[11] and provide exceedingly little information to them. "Private" securities offerings and any subsequent trading in these increasingly large and numerous companies lack much of the essential information and many of the investor protections that have been hallmarks of U.S. capital markets since the 1930s.[12] Without robust information and accountability, companies have engaged in a myriad of troubling practices, ranging from taking dubious financial risks, to inappropriately compensating senior executives, to putting workers at risk.[13] Just about every aspect of the market is less efficient too, featuring exacerbated agency costs, elevated risks (including trading costs, valuation risks, and market risks),[14] and more fertile ground for fraud

[9] *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets*, SEC, 85 Fed. Reg. 17956, 17957 (Mar. 31, 2020). Notably, even the SEC is forced to estimate the totals because the SEC's record-keeping and disclosure requirements regarding such offerings are so lax. See, id., n.12. This has given rise to calls by investor advocates and the North American Securities Administrators Association for the Commission to impose significantly enhanced disclosures on parties relying on offering exemptions and for enhanced data collection by the agency itself. See, e.g., Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, Hearing before the Committee on Financial Services, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, 116th Cong. (2019) (Testimony of Michael Pieciak) *available at* https://www.nasaa.org/wp-content/uploads/2019/09/NASAA-Written-Testimony-HFSC-IPECM-Commissioner-Michael-Pieciak.pdf.

[10] See, e.g., Miles Kruppa, *Carta plans private share trading platform to rival Nasdaq*, Financial Times, May 10, 2020, *available at* https://www.ft.com/content/d52b0487-b13c-4bae-bf27-770518ff083d (quoting Carta CEO Henry Ward saying "If CartaX wins, in 10 years there won't be a NYSE or a Nasdaq."); see also, Alexander Osipovich, *High-Speed Trader GTS to Create Online Market for Pre-IPO Shares*, Wall St. J., Apr. 22, 2020, *available at* https://www.wsj.com/articles/high-speed-trader-gts-to-create-online-market-for-pre-ipo-shares-11587555001.

[11] See, e.g., EquityZen, Frequently Asked Question, *available at* https://equityzen.com/faq/?utm_source=google&utm_medium=ad&utm_campaign=888752132&utm_term=sitelink&utm_content=none&gclid=EAIaIQobChMIyfLIqf296QIVFaSzCh3h_w4ZEAAYASACEgLHFvD_BwE (reflecting five percent transaction fees per side per trade, plus potential ongoing fees).

[12] *Concept Release on Harmonization of Securities Offerings*, SEC, Sec. Act Rel. No. 33-10649, at 33, Jun. 18, 2019 (stating "Issuers in [Rule 506] offerings are not required to provide any substantive disclosure and are permitted to sell securities to an unlimited number of accredited investors with no limit on the amount of money that can be raised from each investor or in total.").

[13] Renee M. Jones, *The Unicorn Governance Trap*, 166 U. Pa. L. Rev. Online (2017), *available at* https://scholarship.law.upenn.edu/penn_law_review_online/vol166/iss1/9.

[14] Letter from Tyler Gellasch, Healthy Markets Association, to Vanessa Countryman, SEC, Sept. 30, 2019, *available at* https://healthymarkets.org/wp-content/uploads/2019/09/SEC-Concept-Release-9-30-19-1.pdf.

and manipulation.[15] These unavoidable realities negatively impact far more than just investors, but also business partners, competitors, workers, and more.[16]

Indeed, the recent crisis has starkly illustrated the profound risks to workers, companies, and the economy from the rapid expansion of private markets. As a recent statement recognizes, investors, taxpayers, and other stakeholders in America's companies need to know how companies are navigating the crises, including their use of various governmental assistance programs.[17] These disclosures are essential to effective oversight—in corporate governance matters, in labor-management relations, and in broader public policy areas. And we have already seen disclosure work as intended. Once some public companies began disclosing their receipt of federal assistance, for example, there was an immediate public outcry, the terms of the programs were revised, and companies were advised to give funds back to the government.

Yet with far too many large companies no longer in the public markets, this critical oversight protection is lost. Investors in private companies, their workers, their business partners, and even their government may lack this essential information.

For example, without company-mandated disclosures, the public may never know the true scope of the Federal Reserve System's bailout of oil and gas companies, and if aide has wrongfully flowed to undeserving hands.[18] The negative impacts extend not only to the carbon-related financial stability risk that the Federal Reserve itself is now financing—one which needs full transparency across the Fed's portfolio—but also the efficient allocation of capital.[19] The Fed is using its resources to support the finances of some companies, and not others, with implications on those companies' investors, employees, business partners and more. Are these choices being made wisely? Without transparency and accountability, the public's trust in business and government is undermined.

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[15] Verity Winship, *Private Company Fraud*, University of Illinois College of Law, 2020, *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3538499. *See also* Elizabeth Pollman, *Private Company Lies*, 109 Geo. L.J. __ (forthcoming 2020), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3551565.

[16] Urska Velikonja, *The Cost of Securities Fraud*, 54 William & Mary Law Review 1887–1957 (2013), *available at* https://scholarship.law.wm.edu/wmlr/vol54/iss6/4/.

[17] Statement of Jay Clayton and William Hinman, *The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19*, SEC, Apr. 8, 2020, *available at* https://www.sec.gov/news/public-statement/statement-clayton-hinman.

[18] See Victoria Guida and Zack Colman, *Fed's expansion of lending program sparks oil bailout worries*, Politico, Apr. 30, 2020, *available at* https://www.politico.com/news/2020/04/30/feds-expansion-of-lending-program-sparks-oil-bailout-worries-227545.

[19] Important questions have been raised too about the SEC's role in inflating oil and gas company balance sheets. See Mark K. DeSantis, *How Cheap Federal Leases Benefit Oil and Gas Companies*, Center for American Progress, August 29, 2018, *available at* https://www.americanprogress.org/issues/green/reports/2018/08/29/455138/cheap-federal-leases-benefit-oil-gas-companies/.

Concerns for investors and the public that are multiplying in this crisis are not confined to COVID-19. Twice over the past dozen years, corporate America has demanded and received trillion-dollar taxpayer-backed bailouts. With climate change a systemic risk to the financial system, it is essential to that ensure investors and the public are better prepared to address economic shocks.[20] The SEC must do things differently.

The Commission needs to restore public capital markets to help address these challenges.

<u>The SEC Is Moving In the Wrong Direction</u>

The Commission's numerous recent deregulatory actions have and will (1) reduce the requirements for companies to make disclosures, and (2) reduce the ability of investors to act based on that information. These actions do not protect investors, maintain fair, orderly, and efficient markets, facilitate capital formation, or serve the broader public interest. Instead, they will do the opposite.

We wish to highlight several examples in which the Commission should change direction.

Eroding the Public Company Regulatory Framework

The SEC and Congress, in various measures since the 1980s, have engaged in successive rounds of deregulation attacking the public company regulatory framework.[21] As noted above, the impact of these changes has been enormous, dramatically undermining the scope of the public markets and replacing them with "private" securities markets.

Against this already troubling backdrop, the agency has proposed its most sweeping reforms to its public company regulatory framework in decades. The Commission's June 2019 Concept

[20] Gregg Gelzinis and Graham Steele, *Climate Change Threatens the Financial System*, Center for American Progress, Nov. 21, 2019, *available at* https://www.americanprogress.org/issues/economy/reports/2019/11/21/477190/climate-change-threatens-stability-financial-system/; and see, also, e.g., Lael Brainard, *Why Climate Change Matters for Monetary Policy and Financial Stability*, Board of Governors of the Federal Reserve System, Nov. 8, 2019, *available at* https://www.federalreserve.gov/newsevents/speech/brainard20191108a.htm; Federal Reserve Bank of San Francisco, *The Economics of Climate Change*, Nov. 8, 2019, *available at* https://www.frbsf.org/economic-research/events/2019/november/economics-of-climate-change/; Mark Carney, *Breaking the tragedy of the horizon – climate change and financial stability: Speech at Lloyd's of London*, Bank for International Settlements, Sept. 29, 2015, *available at* https://www.bis.org/review/r151009a.pdf.

[21] See Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, (Duke University School of Law, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2951158; Renee M. Jones, *The Unicorn Governance Trap*, 166 U. Pa. L. Rev. Online 165, 178 (2017), *available at* https://scholarship.law.upenn.edu/penn_law_review_online/vol166/iss1/9; Letter from Erik F. Gerding, et. al., to Vanessa Countryman, SEC, Sept. 24, 2019, *available at* https://www.sec.gov/comments/s7-08-19/s70819-6193340-192501.pdf.

Release,[22] as well as subsequent rulemaking proposals in December 2019[23] and March[24] of this year are breathtaking both in scope and impact. By expanding the scope of persons outside the protections of the public company regulatory framework and further loosening important limitations on offerings outside of that framework, these "private markets" proposals together represent aggressive deregulation of the capital markets.

Together, these proposals aggravate an initial public offering (IPO) off-ramp that enables large companies to avoid disclosure requirements and effective corporate governance features. Moreover, these proposals drain liquidity from the public markets—liquidity that protects investors and also drives economic growth. Although ostensibly about adding investment choice, these policies actually reduce information and choice by encouraging current public companies to go dark and other companies to not pursue the IPO route. What is perhaps most disappointing, the Commission has been repeatedly marketing these proposals in the name of investors, yet, as shown in letter[25] after letter, real investors and their advocates—unlike the troubling astroturfing campaign orchestrated to fool the Commission[26]—overwhelmingly oppose them.

Put simply, at the very moment that investors and the public are demanding more information about companies, the Commission is proposing to dramatically expand the scope of securities offerings and trading transactions for which the public disclosure regime and other investor protections will generally not apply.

The harms from the SEC's trajectory are tangible. Capital markets function best and are most stable when robust disclosure allows investors to police the decisions of management and also enables markets to price risk. By eliminating the ability of investors and broadly distributed stakeholders to hold companies and their executives accountable to longer term interests, expanded private markets further concentrate corporate power in a small number of

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[22] *Concept Release on Harmonization of Securities Offering Exemptions*, SEC, 84 Fed. Reg. 30460, (June 26, 2019), *available at* https://www.govinfo.gov/content/pkg/FR-2019-06-26/pdf/2019-13255.pdf ("Exemptions Concept Release").

[23] *Amending the 'Accredited Investor' Definition*, SEC, 85 Fed. Reg. 2574, (Jan. 15, 2020), *available at* govinfo.gov/content/pkg/FR-2020-01-15/pdf/2019-28304.pdf.

[24] *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets*, SEC, 85 Fed. Reg. 17956, (Mar. 31, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-03-31/pdf/2020-04799.pdf.

[25] *Recommendation Relating to SEC Guidance and Rule Proposals on Proxy Advisors and Shareholder Proposals*, Investor Advisory Committee of the Securities and Exchange Commission, Jan. 24, 2020 *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/sec-guidance-and-rule-proposals-on-proxy-advisors-and-shareholder-proposals.pdf.

[26] Letter from Better Markets to Jay Clayton, SEC, Dec. 9, 2019, *available at* https://bettermarkets.com/sites/default/files/Fraudulent_comment_letters_-_Letter_to_SEC_12-9-19.pdf

unaccountable hands.[27] Fraud and market manipulation are all too common in private securities markets, and Rule 10b-5 liability, by itself, provides an inadequate check.[28]

But there are many other concerns. The Commission and the public has seen the power of the registration process over the years. Despite increasingly problematic business cultures, when several very large private companies became subject to public disclosures and scrutiny, market discipline forced change.[29] In just one notable recent case, the public registration process brought to light self-dealing by executives and the use of questionable accounting metrics. Armed with this information, valuations quickly plummeted to more realistic levels and executives were replaced.[30]

Adding private offering alternatives with more limited (or no) disclosures does not, in fact, add options for investors—it eliminates them. Even if companies voluntarily provide more information than required, markets have a difficult time evaluating such information without the ability to compare with other companies. As a result, investors will discount such information, thereby eliminating the high-disclosure, high-value option for investors and companies alike.

Corporations and executives also work better when they know they will be held accountable for their actions. That can only happen when investors, corporate stakeholders like workers, and the public have meaningful information and corporate governance rights. In particular, the rapid expansion of environmental, social and governance (ESG) investing and accountability are

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[27] *Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social, and Governance Disclosures*, Hearing Before the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, Comm. on Fin. Svcs, 116th Cong. (2019) (Testimony of James Andrus, CalPERS, at 3)("This raises an important point for today's discussion: most of the ESG-related policy dialogue focuses only on the public markets. Moving forward, we encourage you to also consider how important ESG issues like those we are discussing today can be carried into the non-public market space as well."), *available at* https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404000.

[28] Verity Winship, *Private Company Fraud*, University of Illinois College of Law, 2020, *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3538499. *See also* Elizabeth Pollman, *Private Company Lies*, 109 Geo. L.J. __ (forthcoming 2020), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3551565.

[29] See Renee M. Jones, *The Unicorn Governance Trap*, 166 U. Pa. L. Rev. Online 165, 178 (2017), *available at* https://scholarship.law.upenn.edu/penn_law_review_online/vol166/iss1/9.

[30] See, e.g., Eliot Brown, *How Adam Neumann's Over-the-Top Style Built WeWork. 'This Is Not the Way Everybody Behaves.',*" Wall St. Journal, Sept. 18, 2019, *available at* https://www.wsj.com/articles/this-is-not-the-way-everybody-behaves-how-adam-neumanns-over-the-top-style-built-wework-11568823827; Alex Wilhelm, *WeWork CEO Returns $5.9M To Company, Promises To Add Woman To Board After IPO*, *Crunchbase*, Sept. 4, 2019, *available at* https://news.crunchbase.com/news/wework-ceo-returns-5-9m-to-company-promises-to-add-woman-to-board-after-ipo/; Jordan French, *Tech IPO stumbles beg the question: Why are startup internal controls so poor?*, *VentureBeat*, Oct. 13, 2019, *available at* https://venturebeat.com/2019/10/13/tech-ipo-stumbles-beg-the-question-why-are-startup-internal-controls-so-poor/.

almost entirely dependent on the public company regulatory regime. Any attack on public markets is an attack on that vision of corporate long-termism and shared prosperity.[31]

The current pandemic crisis has further underscored the significant risk of certain types of securities, such as collateralized loan obligations, being issued into and traded on private markets, where there are weak disclosure regimes and anemic price discovery.[32] Indeed, financial crises fester in darkened capital markets. Markets with high incidences of risk, fraud, and manipulation also are unlikely to inhibit strong and stable valuations, which are essential to enabling investor confidence and a speedy recovery.[33]

Ultimately, the Commission's efforts to turbocharge the growth of private markets comes at the expense of the public markets[34] that are vital to recapitalizing American businesses and making our economy more resilient to upcoming threats, such as climate change.[35] Indeed, public companies appear, initially, to be faring somewhat better than private companies during the pandemic, with even some of the more troubled larger companies able to raise money in the public markets while a number of prominent private companies have entered bankruptcy.[36] Even before the pandemic, private equity (one corner of the private markets) was no longer

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[31] Andy Green and Andrew Schwartz, *Corporate Long-Termism, Transparency, and the Public Interest*, Center for American Progress, Oct. 2, 2018, *available at* https://www.americanprogress.org/issues/economy/reports/2018/10/02/458891/corporate-long-termism-transparency-public-interest/.

[32] *Emerging Threats to Stability: Considering the Systemic Risk of Leveraged Lending, Before the Subcommittee on Consumer Protection and Financial Institutions, Committee on Fin. Svcs*, 116th Cong. (2019), (Testimony of Erik Gerding), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3403090.

[33] Elizabeth Pollman, *Private Company Lies*, 109 Geo. L.J. __ (forthcoming 2020), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3551565.

[34] Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, (Duke University School of Law, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2951158.

[35] Center for International Environmental Law, *Trillion Dollar Transformation: Fiduciary Duty, Divestment, and Fossil Fuels in an Era of Climate Risk*, (2016), *available at* https://www.ciel.org/wp-content/uploads/2016/12/Trillion-Dollar-Transformation-CIEL.pdf.

[36] See, e.g., Joshua Franklin, Cruise operator Carnival pays high price to get credit investors on board, April 1, 2020, Reuters, available at https://www.reuters.com/article/us-health-coronavirus-carnival/cruise-operator-carnival-pays-high-price-to-get-credit-investors-on-board-idUSKBN21K07H; William Louch and Laura Cooper, *Coronavirus Unravels Private-Equity Playbook for Some Retailers*, *Wall St. Journal*, May 10, 2020, *available at* https://www.wsj.com/articles/coronavirus-unravels-private-equity-playbook-for-some-retailers-11589115600; see also Brad Moon, *14 Bankruptcy Filings Chalked Up to COVID-19*, *Kiplinger*, May 22, 2020, *available at* https://www.kiplinger.com/slideshow/investing/T052-S001-bankruptcy-filings-chalked-up-to-covid-19/index.html Notably, many of the public company bankruptcies appear to be in the oil and gas sector, which exhibits certain similar dynamics to the private markets with heavy reliance on debt and especially leveraged loan debt. See Institute for Energy Economics and Financial Analysis, *The Oil Industry Has Been in Financial Trouble for Years*, April 2, 2020, *available at* https://ieefa.org/wp-content/uploads/2020/04/IEEFA-Oil-Industry-Finance_April-2020.pdf; Fitch Wire, "Low Oil Prices, Record Volatility Will Hasten US Energy Defaults," April 27, 2020, *available at* https://www.fitchratings.com/research/corporate-finance/low-oil-prices-record-volatility-will-hasten-us-energy-defaults-27-04-2020.

yielding significantly better financial returns than public markets.[37] Yet even core users of private markets themselves, such as venture capital funds and private family businesses, are harmed by the decline of robust public markets, as exit options, valuations, and investor confidence all deteriorate.[38]

The Healthy Markets Association,[39] the Council of Institutional Investors,[40] the Consumer Federation of America,[41] Americans for Financial Reform Education Fund,[42] Better Markets,[43] more than a dozen of the leading securities law academics,[44] and many others all indicated that the health of the U.S. capital markets depends on robust and transparent public markets, which are being directly undermined by the Commission's recent regulatory actions and would be decimated by the adoption of its numerous proposals. The Commission should be supporting a more robust IPO on-ramp by limiting, not dramatically expanding, private markets.

Lastly, we are deeply troubled by the SEC's decision to loosen, without any public input or justification, the requirements for its Regulation Crowdfunding rules.[45] While we are sympathetic to the needs of small businesses for financial assistance in these extraordinary times,[46] we see no evidence that exposing investors to greater risks and less information—while in the midst of an economic crisis—will spur sound investments and economic growth.

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[37] See, e.g., Robert S. Harris, Tim Jenkinson & Steven N. Kaplan, *How Do Private Equity Investments Perform Compared to Public Equity?*, 14 J. INV. MGMT. 14, 15 (2016); Ludovic Phalippou, *Performance of Buyout Funds Revisited?*, 18 REV. FIN. 189, 189 (2014); Ludovic Phalippou & Oliver Gottschalg, *The Performance of Private Equity Funds*, 22 REV. FIN. STUD. 1747, 1747 (2009); Berk A. Sensoy, Yingdi Wang & Michael S. Weibach, *Limited Partner Performance and the Maturing of the Private Equity Industry*, 112 J. FIN. ECON. 320, 341-42 (2014).
[38] Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, (Duke University School of Law, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2951158; see also Renee M. Jones, *The Unicorn Governance Trap*, 166 U. Pa. L. Rev. Online (2017), *available at* https://scholarship.law.upenn.edu/penn_law_review_online/vol166/iss1/9.
[39] Letter from Tyler Gellasch, Healthy Markets Association, to Vanessa Countryman, SEC, Sept. 30, 2019, *available at* https://www.sec.gov/comments/s7-08-19/s70819-6233891-192709.pdf.
[40] Letter from Jeffrey P. Mahoney, Council of Institutional Investors, to Vanessa Countryman, SEC, Oct. 3, 2019, *available at* https://www.sec.gov/comments/s7-08-19/s70819-6249226-192752.pdf.
[41] Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, to Vanessa Countryman, SEC, Oct. 1, 2019, *available at* https://www.sec.gov/comments/s7-08-19/s70819-6235037-192692.pdf.
[42] Letter from Marcus Stanley and Heather Slavkin Corzo, Americans for Financial Reform Education Fund, to Vanessa Countryman, SEC, Sept. 30, 2019, *available at* https://www.sec.gov/comments/s7-08-19/s70819-6233332-192690.pdf.
[43] Letter from Dennis M. Kelleher and Lev Bagramian, Better Markets, to Vanessa Countryman, SEC, Sept. 24, 2019, *available at* https://www.sec.gov/comments/s7-08-19/s70819-6190689-192472.pdf.
[44] Letter from Erik F. Gerding, et. al., to Vanessa Countryman, SEC, Sept. 24, 2019, *available at* https://www.sec.gov/comments/s7-08-19/s70819-6193340-192501.pdf.
[45] *Temporary Amendments to Regulation Crowdfunding*, SEC, Temporary Final Rule, May 4, 2020, *available at* https://www.sec.gov/news/press-release/2020-101.
[46] See, e.g., Alexandra Thornton and Andy Green, *How Congress Can Help Small Businesses Weather the Coronavirus Pandemic*, Center for American Progress, April 13, 2020, *available at* https://www.americanprogress.org/issues/economy/news/2020/04/13/483067/congress-can-help-small-businesses-weather-coronavirus-pandemic/.

Even more troublingly, we fear that the Commission is failing to fulfill its most basic procedural obligations. Simply ignoring the law and deregulating based upon ideological dispositions and anecdote, without public input, is not a sustainable model. This practice also raises serious concerns under the Administrative Procedure Act.

Eroding the Value of Existing Public Company Disclosures

The Commission has proposed stripping existing disclosures for public companies. Investors and the public are increasingly seeking more comparable information from companies regarding a broader scope of issues than ever before. For example, in response to the COVID-19 crisis, investors are seeking more information on companies' supply chain risks and worker health and wellbeing. Investor concerns may range from tax policies to political spending to any number of other ESG issues.[47] At the same time, modern technologies permit issuers to more easily aggregate and disclose, and stakeholders to assimilate, analyze, and use that information more effectively than ever before.

Nevertheless, the SEC is proposing to eliminate, reduce, and otherwise undermine the utility of disclosures by public companies. Recently, for example, the agency proposed "modernizing" Regulation S-K, ostensibly to reflect the fact that capital markets and the economy have both changed in the more than 30 years since adoption.[48] However, the focus of the proposal is to move disclosure away from detailed, objective, and comparable standards to ambiguous, amorphous, less comparable "principles."

As various experts,[49] including Commissioners Robert Jackson and Allison Lee[50] have noted, a more principles-based approach to disclosures gives companies more discretion over what kind of information they share with investors. This would reduce the quality and comparability of

[47] *See, e.g.*, Bruce F. Freed and Karl J. Sandstrom, Center for Political Accountability, *Taking the Lead in Adopting Political Transparency in the COVID-19 Crisis*, Harvard Law School Forum on Corporate Governance, May 7, 2020, *available at* https://corpgov.law.harvard.edu/2020/05/07/taking-the-lead-in-adopting-political-transparency-in-the-covid-19-crisis/; see also Rachel Curley, *Silenced No More, A Champion of Transparency Speaks Out*, Public Citizen, Nov. 4, 2019, *available at* https://www.citizen.org/news/sec-political-spending/; Testimony of Heather Slavkin Corzo Before Financial Services Committee Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, U.S. House of Representatives, *On Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers*, May 15, 2019, *available at* https://www.congress.gov/116/meeting/house/109493/witnesses/HHRG-116-BA16-Wstate-SlavkinCorzoJDH-20190515.pdf; Christian Freymeyer, *Trending Toward Transparency*, FACT Coalition, Apr. 2019, *available at* https://thefactcoalition.org/report/trending-toward-transparency/?utm_medium=policy-analysis%2Freports%2Ffact-reports; Letter from Cynthia Williams and Jill Fisch to Brent Fields, SEC, Petition for Rulemaking on ESG Disclosure, Oct. 1, 2018, *available at* https://www.sec.gov/rules/petitions/2018/petn4-730.pdf.

[48] *Modernization of Regulation S-K Items 101, 103, and 105*, SEC, 84 Fed. Reg. 44538, *available at* https://www.govinfo.gov/content/pkg/FR-2019-08-23/pdf/2019-17410.pdf ("S-K Modernization Proposal").

[49] Letter from Dennis Kelleher, Stephen Hall, Lev Bagramian, Better Markets to Vanessa Countryman, Oct. 22, 2019, *available at* https://bettermarkets.com/sites/default/files/CL_SEC_Modernization_of_Reg_S-K_10-16-19_0.pdf.

[50] Hon. Robert J. Jackson, Jr. and Hon. Allison Herren Lee, *Joint Statement on Proposed Changes to Regulation S-K*, SEC, Aug. 27, 2019, *available at* https://www.sec.gov/news/public-statement/statement-jackson-lee-082719.

information disclosed. Moreover, we note that a lack of specific disclosure requirements will mean that industry practices may diverge over time. This would leave the Commission in a position of either not enforcing intended disclosure requirements or being subject to accusations that it is pursuing regulation by enforcement.[51] Just as significantly, private investors that have been the victim of fraud will be in a far weakened position in protecting their own property rights.[52] Capital markets and broader economic efficiency will be negatively impacted by the inability of market participants to effectively distinguish between quality corporate leadership and poor management strategies.[53]

The materiality standard is too often misunderstood and misapplied. Too many securities professionals forget that the legal lodestone is whether information is material *to investors*, and not how executives of the company might perceive it impacts the company's finances.[54] Although the addition of "human capital" as one of the topics to be disclosed is one of the few bright spots in the SEC's recent agenda,[55] the proposed rule[56] fails to include information around climate change as a required topic for disclosure. This failure is glaring given how many investors now view climate change as a critically important factor in making decisions—a point made by thousands of comments to the Commission over the years, and with distinct clarity by Commissioner Lee in recent months.[57]

The Commission's proposed changes to the management discussion and analysis section of corporate disclosure exhibit a similar thrust towards reducing disclosure content, comparability,

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[51] Mark Schoeff, Jr., *Financial industry opponents remain wary of SEC's crackdown on share class disclosure*, Investment News, Apr. 20, 2020, *available at* https://www.investmentnews.com/advisers-wary-sec-share-class-disclosure-191798.

[52] See, generally, Andy Green, *Opinion: Could the SEC secretly abolish investors' right to sue?*, MarketWatch, Mar. 2, 2019, *available at* https://www.marketwatch.com/story/could-the-sec-secretly-abolish-investors-right-to-sue-2018-03-02#false.

[53] See Urska Velikonja, *The Cost of Securities Fraud*, 54 William & Mary Law Review 1887–1957 (2013), *available at* https://scholarship.law.wm.edu/wmlr/vol54/iss6/4/.

[54] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).
Giving investors the chance to understand management's perceptions is what the Management's Discussion and Analysis section of the SEC's reporting is supposed to provide. See Sondra L. Stokes, *Remarks Before the 2006 AICPA National Conference on Current SEC and PCAOB Developments*, SEC, Dec. 13, 2006, *available at* https://www.sec.gov/news/speech/2006/spch121306sls.htm.

[55] Amanda Iocone, *Return to Work Puts Spotlight on Disclosure, SEC's Clayton Says*, Bloomberg, May 4, 2020, available at https://news.bloombergtax.com/financial-accounting/return-to-work-puts-spotlight-on-disclosure-secs-clayton-says; See generally, Angela Hanks, Ethan Gurwitz, Brendan Duke, and Andy Green, *Workers or Waste?*, Center for American Progress, June 8, 2016, *available at* https://www.americanprogress.org/issues/economy/reports/2016/06/08/138706/workers-or-waste/.

[56] S-K Modernization Proposal.

[57] See, e.g., Hon. Allison Herren Lee, *Modernizing Regulation S-K: Ignoring the Elephant in the Room*, SEC, Jan. 30, 2020, *available at* https://www.sec.gov/news/public-statement/lee-mda-2020-01-30; see also Tyler Gellasch, *Towards a Sustainable Economy: A Review of Comments to the SEC's Disclosure Effectiveness Concept Release*, Public Citizen, 2016, *available at* https://www.citizen.org/sites/default/files/sustainableeconomyreport.pdf.

and utility.[58] As the CFA Institute and Council of Institutional Investors point out, these proposals shift the burden from companies to investors in terms of collecting and providing useful information.[59]

The Commission's recent reduction in disclosure on mergers and acquisitions (M&A) transactions exhibit the same flaws.[60] In the face of high levels of M&A activity in the markets in recent years,[61] this misguided final rule reduces transparency, including by lowering the necessary financial statements from three years to two. The current economic crisis is likely to lead to more M&A activity, including in high risk situations of rising insolvencies and in the context of extraordinary Federal support for targets and acquirers.[62] In the face of a declining number of public companies,[63] the SEC should be expanding the ability for investors, other stakeholders, and the public to carefully scrutinize the wisdom of mergers and reject those that will harm investors, raise consumer prices, and undermine robust competition.

The Commission's proposal to weaken transparency around extractive industries practices is another example of its deregulatory agenda facilitating concentration and abuse by decreasing transparency.[64] It is also out of step with international disclosure standards and the needs of investors and stakeholders for robust anti-corruption protections.[65]

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[58] *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, SEC, 85 Fed. Reg. 12068, *available at* https://www.govinfo.gov/content/pkg/FR-2020-02-28/pdf/2020-02313.pdf.

[59] Letter from Sandra Peters, CFA Institute and Jeff Mahoney, Council of Institutional Investors, to Vanessa Countryman, SEC, Apr. 28, 2020, *available at* https://www.sec.gov/comments/s7-01-20/s70120-7135305-216147.pdf.

[60] *Amendments to Financial Disclosures about Acquired and Disposed Businesses*, SEC, Final Rule, RIN 3235-AL77, (May 21, 2020), *available at* https://www.sec.gov/news/press-release/2020-118.

[61] Andy Green, Christian E. Weller, and Malkie Wall, *Corporate Governance and Workers*, Center for American Progress, Aug. 14, 2019, *available at* https://www.americanprogress.org/issues/economy/reports/2019/08/14/473095/corporate-governance-workers/.

[62] See generally, Letter from American Economic Liberties Project, et al., to Hon. Jerome Powell, Federal Reserve Board of Governors and Hon. Steven Mnuchin, Treasury Dep't, May 7, 2020, *available at* https://www.economicliberties.us/press-release/the-federal-reserve-must-not-finance-a-merger-wave/#; Press Release, *Open Markets Calls for Ban on Takeovers by Large Corporation and Funds for Duration of Crisis*, Open Markets Institute et al, Mar. 21, 2020, *available at* https://openmarketsinstitute.org/blogs/open-markets-calls-ban-takeovers-large-corporation-funds-duration-crisis/.

[63] See Craig Doidge, G. Andrew Karolyi, and René M. Stulz, *The U.S. Listing Gap*, Columbia Business School, 2015, *available at* https://www8.gsb.columbia.edu/faculty-research/sites/faculty-research/files/finance/Finance%20Seminar/Fall%202015/Doidge_Karolyi_Stulz_Listing_Gap_July2015.pdf.

[64] Disclosure of Payments by Resource Extraction Issuers, SEC, 85 Fed. Reg. 2522 (Jan. 15, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-01-15/pdf/2019-28407.pdf.

[65] Letter from Lev Bagramian, Better Markets to Vanessa Countryman, SEC, Mar. 16, 2020, *available at* https://bettermarkets.com/sites/default/files/Better_Markets_Comment_Letter_to_the_SEC_on_Disclosure_of_Payments_by_Resource_Extraction_Issuers.pdf; Letter from Clark Gascoigne to Vanessa Countryman, SEC, March 18, 2020, *available at* https://thefactcoalition.org/comments-to-sec-on-proposed-rule-on-disclosure-of-payments-by-resource-extraction-issuers/; see also Business & Human Rights Resource Centre, *USA: SEC's latest draft of payment disclosure rules for oil and mining companies draws criticism from anticorruption groups*, Dec. 18, 2019,

Additionally, the Commission's proposed changes to weaken internal controls[66] and auditor independence[67] further place the disclosure regime at risk. As the CFA Institute explained, expanded exemptions from internal control findings will not achieve the goal of capital formation but will weaken investor protections.[68] The CFA Institute noted that "the industry deriving the most benefiting from this Proposed Rule change – the banking industry – is subject to current concerns regarding its ability to adopt a new critical audit matter that requires strong internal controls."[69] Similarly, the Consumer Federation of America has noted that a lack of quality independent financial reporting leads to financial scandal and investor abuses, with Enron, WorldCom, and the Dot Com crash leading Congress to enshrine auditor independence in the law.[70] Indeed, the U.S. Senate just this week voted 100-0 in support of ensuring that companies listing in U.S. public markets are subject to robust audit quality inspections.[71]

Put simply, the SEC should not be materially reducing the quantity, quality, integrity, and comparability of information that companies provide investors and the public.

Eroding Shareholder Rights

In addition to facilitating the expansion of private securities markets, the Commission has proposed dramatically reducing shareholders' rights in the rapidly decreasing number of public companies.[72]

In particular, the Commission has proposed significantly limiting shareholders' abilities to submit and resubmit proposals for consideration to a company's board of directors.[73] Shareholder proposals provide an essential mechanism for shareholders to communicate with the executives of the companies they own and other shareholders. The proposed changes

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available at https://www.business-humanrights.org/en/usa-secs-latest-draft-of-payment-disclosure-rules-for-oil-and-mining-companies-draws-criticism-from-anticorruption-groups (last accessed May 2020).

[66] *Amendments to the Accelerated Filer and Large Accelerated Filer Definitions*, SEC, 84 Fed. Reg. 24876 (May 29, 2019), *available at* https://www.govinfo.gov/content/pkg/FR-2019-05-29/pdf/2019-09932.pdf.

[67] *Amendments to Rule 2-01, Qualifications of Accountants*, SEC, 85 Fed. Reg. 2332, (Jan. 15, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-01-15/pdf/2019-28476.pdf.

[68] Letter from Kurt N. Schacht and Sandra J. Peters, CFA Institute, to Vanessa Countryman, SEC, Aug. 22, 2019, *available at* https://www.sec.gov/comments/s7-06-19/s70619-6009673-190811.pdf.

[69] *Id.*; see also Letter from Dennis M. Kelleher, Lev Bagramian, Better Markets, to Vanessa Countryman, SEC, July 29, 2019, *available at* https://www.sec.gov/comments/s7-06-19/s70619-5885211-188734.pdf.

[70] Letter from Barbara Roper, Consumer Federation of America, to Vanessa Countryman, SEC, May 4, 2020, *available at* https://www.sec.gov/comments/s7-26-19/s72619-7146025-216304.pdf.

[71] Daniel Flatley and Benjamin Bain, *Senate Passes Bill to Delist Chinese Companies From Exchanges*, Bloomberg News, May 20, 2020, *available at* https://www.bloomberg.com/news/articles/2020-05-20/senate-passes-bill-to-delist-chinese-companies-from-exchanges?sref=T513XH2G.

[72] Notably, the Commission generally establishes no investor rights in so-called private offerings.

[73] *Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8*, SEC, 84 Fed. Reg. 66458, (Dec. 4, 2019), *available at* https://www.govinfo.gov/content/pkg/FR-2019-12-04/pdf/2019-24476.pdf ("Rule 14a-8 Proposal").

would dramatically increase stock ownership requirements and vote resubmission requirements, making the entire shareholder proposal process inaccessible to all but the largest investors. The thresholds are so high that even many of the largest investors may lose access to these important corporate governance rights.[74]

To be clear, there is no overwhelming glut of shareholder proposals currently overburdening corporate executives. In fact, as the Council of Institutional Investors has explained to the Commission:

> Most public companies do not receive any shareholder proposals. On average, 13% of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017. In other words, the average Russell 3000 company can expect to receive a proposal once every 7.7 years. For companies that receive a proposal, the median number of proposals is one per year.[75]

The already limited use of proxy proposals suggests that these efforts to restrict the process are not being driven by facts, but by ideology.

The proposed changes unfortunately seem to target the very types of proposals that have been gaining favor in recent years: those related to workers' rights, climate risks, supply chain risks, taxes, and other critical ESG issues—the very ESG issues that the SEC's own Investor Advisory Committee recently found to be material to investment and voting decisions.[76]

Not only would the limitations on resubmissions dramatically undermine corporate long-termism, they would also cut off pioneering risk management efforts by smaller investors—ones that have often built support among shareholders thanks to multi-year efforts. Stock option expensing, director independence requirements, and executive compensation clawbacks are just a few of the many examples of multi-year shareholder proposals that have at times been successful, and which would likely be cut off under the new rule.[77]

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[74] See Letter from Marcie Frost, CalPERS, to Vanessa Countryman, SEC, Feb. 3, 2020, *available at* https://www.sec.gov/comments/s7-23-19/s72319-6744100-207900.pdf.

[75] Letter from Kenneth Benson and Jeff Mahoney, Council of Institutional Investors, to Vanessa Countryman, SEC, Jan. 30, 2020, *available at* https://www.sec.gov/comments/s7-23-19/s72319-6729684-207400.pdf.

[76] SEC Investor Advisory Committee, Recommendation from the Investor-as-Owner Subcommittee Relating to ESG Disclosure, May 14, 2020, *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf.

[77] Letter from Brandon J. Rees, AFL-CIO, to Vanessa Countryman, SEC, Feb. 3, 2020, *available at* https://www.sec.gov/comments/s7-23-19/s72319-6744323-207881.pdf; see also Investor Rights Forum, *Demonstrating Positive Impacts Of Shareholder Proposals*, *available at* https://www.investorrightsforum.com/casestudies.

The ability of shareholders to exercise meaningful corporate governance rights has become all the more important with the COVID-19 crisis. Investors have legitimate concerns and interest in a company's readiness for pandemics, the climate crisis, and other supply chain and macroeconomic disruptions. Investors and stakeholders want more power not less to engage the companies and industries worst prepared for such calamities.

Lowering the accountability of management in the midst of a massive economic and health care crisis risks undermining investor confidence in issuers. At a minimum, shareholders need to have the ability to demand accountability from management to ensure that capital, including capital being supported by unprecedented taxpayer-funded interventions, is not being misused to enrich corporate management or well-connected creditors. Investors also must have the ability to demand greater disclosure of the political activities of management, including contributions to 501(c)(4) "dark money" organizations and lobbying for government support, legislation, or regulatory changes.[78] Reducing the ability of stakeholders to demand accountability from management not only increases agency costs, it also threatens the legitimacy of corporate governance and public trust in the financial system.

Furthermore, the pandemic and economic crises have revealed the extent to which workers have inadequate health and economic security, imperiling not only individual households, but also the collective viability of corporations and the greater economy.[79] Constraining the ability of investors to make proposals to protect workers and promote social governance initiatives at this particular historical moment presents grave risks for companies, investors, the economy, and the legitimacy of the Commission.

Investors and market thought-leaders overwhelmingly opposed these anti-investor actions: CalPERS,[80] the Center for Political Accountability,[81] Ceres,[82] CFA Institute,[83] the Council of

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[78] See Bruce F. Freed and Karl K. Sandstrom, *Taking the Lead in Adopting Political Transparency in the COVID-19 Crisis, Harvard Law School Forum on Corporate Governance*, May 7, 2020, *available at* https://corpgov.law.harvard.edu/2020/05/07/taking-the-lead-in-adopting-political-transparency-in-the-covid-19-crisis/; Bruce Freed, "Taking government money? Disclose your political spending: Companies should opt for transparency now more than ever," *New York Daily News*, May 8, 2020, available at https://www.nydailynews.com/opinion/ny-oped-taking-government-money-20200508-inu4noupqfg53iq3mjfebsuspe-story.html.

[79] See David Madland, Sarah Jane Glynn, Jacob Leibenluft, and Simon Workman, *How the Federal Government Can Protect Essential Workers in the Fight Against Coronavirus*, Center for American Progress, Apr. 8, 2020, *available at* https://www.americanprogress.org/issues/economy/news/2020/04/08/482881/federal-government-can-protect-essential-workers-fight-coronavirus/.

[80] Letter from Marcie Frost, CalPERS, to Vanessa Countryman, SEC, Feb. 3, 2020, *available at* https://www.sec.gov/comments/s7-23-19/s72319-6744100-207900.pdf.

[81] Letter from Bruce Freed and Dan Carroll, Center for Political Accountability, Jan. 31, 2020, *available at* https://www.sec.gov/comments/s7-23-19/s72319-6730871-207448.pdf.

[82] Letter from Mindy Lubber, Ceres, to Vanessa Countryman, SEC, Feb. 3, 2020, *available at* https://www.sec.gov/comments/s7-23-19/s72319-6771580-208107.pdf.

[83] Letter from James Allen, CFA Institute, to Vanessa Countryman, SEC, Feb. 3, 2020, *available at* https://www.sec.gov/comments/s7-23-19/s72319-6738827-207642.pdf.

Institutional Investors,[84] Consumer Federation of America,[85] and more.[86] While the comment period for this proposal ended before the COVID-19 crisis began in earnest in the United States, the negative implications for its adoption would be even greater today. The Commission's proposed rollback of corporate accountability would be especially egregious considering the exceptional level of interest among investors and companies in *expanding* corporate accountability to stakeholders.

Moreover, these changes must also be considered against the backdrop of the Commission's proposed limitations and burdens on proxy advisory firms,[87] such as requirements to provide companies with an advance opportunity to review the analyses of these firms and other steps to burden and stifle independent viewpoints.[88] Without the effective check on management that was formerly played by much more widespread union collective bargaining, this toxic mix of proposals builds on one another to strengthen corporate management and weaken stakeholders.[89]

Individually and especially in combination, these proposals would stifle shareholder democracy as a vital mechanism of risk management, result in an alarming concentration of corporate voting and power in the hands of a tiny number of investment firms, and further empower executives at the expense of stakeholders. These efforts, in our view, result in the Commission straying from its obligations to protect investors, promote competition, and facilitate fair and efficient markets. If adopted, the proposed reforms would do grave injustice to Ms. and Mr. 401(k) who are invested for the long-term.

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[84] Letter from Ken Bertsch and Jeff Mahoney, Council of Institutional Investors, to Vanessa Countryman, SEC, May 19, 2020, *available at* https://www.sec.gov/comments/s7-23-19/s72319-7214366-216887.pdf; Letter from Ken Bertsch and Jeff Mahoney, Council of Institutional Investors, to Vanessa Countryman, SEC, Jan. 30, 2020, *available at* https://www.sec.gov/comments/s7-23-19/s72319-6729684-207400.pdf.

[85] Letter from John Coates, Harvard Law School and Barbara Roper, Consumer Federation of America, to Vanessa Countryman, SEC, Jan. 30, 2020, *available at* https://www.sec.gov/comments/s7-23-19/s72319-6729667-207388.pdf.

[86] Letter from Dennis Kelleher, Stephen Hall, Lev Bagramian, Better Markets to Vanessa Countryman, SEC, Febr. 3, 2020, *available at* https://bettermarkets.com/sites/default/files/Better_Markets_Comment_Letter_on_Procedural_Requirements_and_Resubmission_Thresholds_Under_Exchange_Act_Rule_14a-8_%28Release_Number_34-87458%29.pdf.

[87] We appreciate that the Commission has been sharply divided on many of these controversial efforts. Contrast, Hon. Robert J. Jackson Jr, *Statement on Proxy-Advisor Guidance*, SEC, Aug. 21, 2019, *available at* https://www.sec.gov/news/public-statement/statement-jackson-082119 from Hon. Elad Roisman, *Statement Regarding Commission Guidance and Interpretation Regarding Proxy Voting and Proxy Voting Advice*, SEC, Aug. 21, 2019, *available at* https://www.sec.gov/news/public-statement/statement-roisman-082119.

[88] *Amendments to Exemptions From the Proxy Rules for Proxy Voting Advice*, SEC, 84 Fed. Reg. 66518 (Dec. 4, 2019), *available at* https://www.govinfo.gov/content/pkg/FR-2019-12-04/pdf/2019-24475.pdf.

[89] See Andy Green, Christian E. Weller, and Malkie Wall, *Corporate Governance and Workers*, Center for American Progress, Aug. 14, 2019, *available at* https://www.americanprogress.org/issues/economy/reports/2019/08/14/473095/corporate-governance-workers/.

We urge the Commission to move in the opposite direction, and pursue actions to expand stakeholder rights, including expanding access to proxies and abilities of investors to more directly identify, evaluate, and vote their interests.[90]

Towards a transparency and accountable corporate governance agenda for COVID-19

The Commission's response to the current crisis should entail three phases.

First, the Commission should immediately cease all regulatory actions that would remove information or rights from investors. This includes all of the proposals outlined above. The Commission should also freeze the rulemaking processes on all non-essential actions until the Commission has a chance to fully evaluate dramatic developments in the markets and give stakeholders the opportunity to ensure their voices are heard in this rapidly-changing environment.[91] Again, the Commission needs to collect data on which markets and companies were fundamentally destabilized and which remain vulnerable. Any emergency actions should be temporary, subject to a sunset, and tightly connected to the COVID-19 emergency.

Second, the Commission should require additional disclosures, effective as soon as possible, to ensure investors and the public have essential information throughout the crisis. A comprehensive, detailed, investor and public policy-driven disclosure mandate should be implemented, and not just for public companies[92] but so-called private companies as well.[93] Investors and taxpayers alike deserve to know how their money is being spent.

For existing reporting companies, the Commission could adopt an interim final rule that would build upon the joint-statement released recently[94] to cover information related to worker rights, healthcare, reliance on direct and indirect federal, state, or other governmental funding or support, and more. The Commission should also urge the Public Company Accounting Oversight

[90] See, e.g., Letter from Stephen Hall, Lev Bagramian, Better Markets to Brent Fields, SEC, Jan. 9, 2017, *available at* https://www.sec.gov/comments/s7-24-16/s72416-1470144-130398.pdf.

[91] Letter from Lev Bagramian, Better Markets to Jay Clayton, SEC, March 31, 2020, *available at* https://bettermarkets.com/sites/default/files/documents/Better_Markets_Letter_to_Chairman_Clayton_Regarding_Tolling_of_Comment_Periods.pdf (arguing that not-freezing rulemaking particularly impacts investor advocates and public interest organizations that are fighting on all fronts and, unlike interested industry representatives, public interest groups do not have the necessary resources to analyze highly complex regulatory proposals not-related to COVID).

[92] We appreciate the Chairman's limited statement regarding disclosures of some relevant topics to investors and the public. Statement of Jay Clayton and William Hinman, *The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19*, SEC, Apr. 8, 2020, *available at* https://www.sec.gov/news/public-statement/statement-clayton-hinman. Interestingly, as the unprecedented federal intervention has unfolded, some of the best sources of information regarding who is receiving what have not been the government, but instead public company filings.

[93] See, Press Release, Waters Announces Committee Plan for Comprehensive Fiscal Stimulus and Public Policy Response to Coronavirus Pandemic, Comm. on Fin. Svcs, Mar. 18, 2020, *available at* https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=406440.

[94] Clayton/Hinman Statement.

Board to prioritize audit reviews by firms who received significant federal assistance. For non-reporting companies, the Commission should work with the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York, to establish basic disclosures as a condition for a company using any federal program.

At a minimum, the Commission should implement immediate special disclosure requirements or conditionality around fundraising focused on:

- the receipt of or reliance upon the federal government's unprecedented financial assistance;
- the treatment of workers—such as paid sick leave, health and safety measures, worker bargaining opportunities, and more;
- present and future supply chain risks, including disruptions that may be caused by extreme weather and natural disaster; and
- pandemic risk disclosures and other similarly urgent, COVID-relevant matters.

Finally, the Commission should undertake a restoration of the public markets, including limiting the private markets and demanding more robust disclosures and rights for investors in the public markets. These efforts should be guided by the principles of promoting the efficient allocation of our people's capital, protecting investors, and promoting sustainable businesses for workers and communities. These efforts should include new disclosures tailored to specific industries, such as the oil and gas industry, and relate not just to operating companies, but to lenders as well. For example, financial institutions should be required to disclose their financing of greenhouse gas emission and the risks associated with such financing.[95] Corporate governance also needs modernization. For example, top-level governance of public companies or those that receive significant governmental support should be reflective of a broad group of stakeholder interests, including the views of workers and their communities.[96]

Conclusion

The Commission's recent deregulatory agenda is further undermining the express purpose of the federal securities laws—to provide for full and fair disclosure of information about securities and issuers to investors and the public, and the ability to act thereupon.

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[95] See, e.g., a methodology set out by the Partnership for Carbon Accounting Financial, available at https://carbonaccountingfinancials.com/. On accounting issues relating to oil and gas leases, see Mark K. DeSantis, *How Cheap Federal Leases Benefit Oil and Gas Companies*, Center for American Progress, August 29, 2018, available at https://www.americanprogress.org/issues/green/reports/2018/08/29/455138/cheap-federal-leases-benefit-oil-gas-companies/.

[96] See, e.g., Andy Green and Andrew Schwartz, *Corporate Long-Termism, Transparency, and the Public Interest*, Center for American Progress, Oct. 2, 2018, *available at* https://www.americanprogress.org/issues/economy/reports/2018/10/02/458891/corporate-long-termism-transparency-public-interest/.

In the face of the most severe economic crisis since the 1930s, America needs robust public markets to finance the economic recovery and recapitalize American businesses. Facing a similar challenge, the New Deal architects of the federal securities laws recognized that economic recovery depended ensuring that capital formation took place within brightly lit public markets where government, investors, workers, and other stakeholders could monitor and discipline management.

We urge the Commission to step back from the path of undermining the decades of success from the federal securities laws and, instead, take steps to constrain the growth of private securities markets and promote corporate disclosure and stakeholder accountability. These changes, which come at minimal costs, would better protect investors and other corporate stakeholders, promote fairer, more orderly and long-term efficient markets, and ensure more sustainable, competitive capital formation.

Thank you for your consideration.

Sincerely,

Andy Green
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Center for American Progress

Lev Bagramian
Senior Securities Policy Advisor
Better Markets

Rachel Curley
Democracy Advocate
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Appendix

We wish to have this comment included in the comment files for the below selected rulemakings:

- Amendments to the Accelerated Filer and Large Accelerated Filer Definitions, Release No. 34-85814, File No: S7-06-19, May 9, 2019.
- Modernization of Regulation S-K Items 101, 103, and 105, Release No. 33-10668, File No: S7-11-19, Aug. 8, 2019.
- Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Release No. 34-87458, File No: S7-23-19, Nov. 5, 2019.
- Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Release No. 34-87457 File No: S7-22-19, Nov. 5, 2019.
- Amending the "Accredited Investor" Definition, Release No. 33-10734, File No: S7-25-19, Dec. 18, 2019.
- Disclosure of Payments by Resource Extraction Issuers, Release No. 34-87783, File No: S7-24-19, Dec. 18, 2019.
- Amendments to Rule 2-01, Qualifications of Accountants, Release No. 33-10738, File No: S7-26-19, Dec. 30, 2019.
- Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information, Release No. 33-10750, File No: S7-01-20, Jan. 30, 2020.
- Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, Release No. 33-10763, File No: S7-05-20, Mar. 4, 2020.

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Statement for the Record
U.S. House Financial Services Subcommittee on
Investor Protection, Entrepreneurship and Capital Markets
"Capital Markets and Emergency Lending in the COVID-19 Era"

June 25, 2020

Ronald C. Parker, President and CEO
National Association of Securities Professionals

On behalf of the National Association of Securities Professionals (NASP), I'm pleased to share some of our views for the Subcommittee's hearing on Capital Markets and Emergency Lending in the COVID-19 era. NASP is the premier organization dedicated to supporting people of color and women in achieving inclusion in the financial services industry. As a professional organization, NASP serves as a resource for the minority professionals within the securities and investments industry and as the voice for its members at the federal, state and local levels of government to advance its mission of diversity and inclusion.

The impact of COVID-19 on the global economy will take years for many individuals to recover from, if at all. This period has illuminated the structural fragility of our economic system in some ways worse than during the Great Depression. Even though the Great Depression took place nearly ninety years ago, in many respects it has never ended for African Americans and Latinos – especially when it comes to the racial wealth gap. In 2018, the Federal Reserve Bank of St. Louis reported than the median net worth of Black families was ten times LESS than that of White families; the net worth of Latinx families was 13% of White families. The study also points out that White families were six times more able to survive on their savings compared to African Americans. Moreover, the same study also points out that Whites are twenty-eight times more likely to become a millionaire than Blacks. To put more context on this statistic – that is a one out of two hundred chance for African Americans vs. one in seven for White Americans. The Latinx wealth gap is also significant. According to the Pew Research Center, White families have three times as much wealth as Latinx families, even when controlling for income tier.

Why is this important as it pertains to this hearing today? NASP focuses on increasing opportunities for asset management and investment banking institutions founded and owned by African Americans, Latinos, women and people of color more broadly at the federal, state, and local governmental levels, as well as with endowments and foundations. Despite NASP members going to some of the best academic institutions in the country, receiving the requisite training at many blue chip investment firms and then moving on to pursue their entrepreneurial dreams, they still fail to receive comparable opportunities to that of their white counterparts, which should be granted on the basis of merit.

What is the opportunity set?

The investment management industry is vast and extremely profitable. In 2016, global assets under management totaled $69.1 trillion and the fees paid to manage those assets were $99 billion. Diverse-owned and woman owned investment managers[1], representing around 8.6% of all investment management companies, remain largely excluded from the opportunities of this industry. Additionally, minority candidates are often absent from the rooms where company policies and decisions are made when it comes to choosing investment

[1] According to the Knight Foundation study, this number includes investment firms with "substantial (defined as 25-49 percent) or majority (50 percent or higher) women or minority ownership".

National Association of Securities Professionals

managers. The decision making around how these assets are managed has far reaching impact across the economy related to job creation, growth, wealth building and too few minority and women owned firms have a seat at the table in this process despite strong track records of proven success.

Why is the context of this aggregate number important? Between 2009 and 2019 BlackRock's assets under management have grown from $3.29 trillion to $6.52 trillion while Black-owned asset management firms such as Holland Capital Management, Herndon Capital Management, and Latino-owned Lombardia Capital Partners all were forced to close their doors.

Investors select investment management companies to steward their capital based on many factors, investment performance being a key driver. The John S. and James L. Knight Foundation, in partnership with Bella Private Markets, published its 2018 Diverse Asset Management Firm Assessment in January 2019. The Knight Foundation report analyzed the performance of diverse and woman owned investment management companies across 4 major asset classes (mutual funds, hedge funds, private equity and real estate), and concluded that their returns were "statistically indistinguishable" from the returns of non-diverse, male owned investment firms. In fact, in some cases the returns generated by diverse and woman owned firms were actually *higher*. Despite this data, diverse and woman owned firms *combined* manage just 1.3% of global assets. This data indicates that these firms are excluded due to bias, not due to a lack of performance or capability.

As we assess the dynamics around the emergency lending facilities during the COVID-19 pandemic, it bears mentioning that the Federal Reserve Bank of New York's selection of BlackRock to manage $750 billion in corporate bonds and mortgage-backed security purchases without any consideration of women and

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minority-owned firms fails in the face of diversity and inclusion. Additionally, the Treasury Department chose three large Wall Street investment banking firms to advise on providing aid to the airline industry, again without consideration of any highly- competent diverse firms.

It was reported in a FundFire article on March 30, 2020 that BlackRock immediately reaped the benefits of their appointment the day after the announcement when $1.5 billion was invested in its exchange-traded-funds (ETFs). This is clear evidence that the Federal Reserve's action gave BlackRock an unfair advantage over its competitors and further widened the gap of disparity between firms dominated by white males and firms that are more diverse.

Indeed, while we still have a long way to go, we want to thank the leadership of the Federal Reserve Bank of New York, in particular Ronald E. Taylor who sits in the Executive Office of Diversity & Inclusion and Daleep Singh, Executive Vice President, Markets Group for their recent leadership and courage to not only increase their level of engagement with NASP and its members, but to elevate its intentionality as it pertains to finding ways to create meaningful partnerships with our member firms on a going forward basis. While the business partnership with the Federal Bank of New York and other Fed banks in the past was not to the level we had hoped, we are optimistic that it will surpass previous levels in a very substantial way in the near term and be sustained over time.

Opening the channels of dialogue with top policy makers, especially regulators, as NASP has with the Federal Reserve Bank of New York, is essential because too often diverse voices are not in the room or at the table when key decisions are made. The Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Securities and Exchange Commission, the Commodities Futures Trading Commission and many other federal regulators have industry professionals and other experts serve on formal advisory committees that focus on various policy and regulatory priorities for

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these agencies. These advisory committees not only perform important roles for the regulators, but they afford their members unique insight into the workings of these agencies and perhaps more notably, give select thought leaders an opportunity to have influence and be perceived to have a voice in the process. These advisory committees are woefully lacking, with few people of color on

them and need to intentionally recruit more diverse participants. NASP stands ready to assist in identifying subject matter experts who can engage thoughtfully on policy matters and support these regulatory entities.

Thank you for your consideration of our views.

Ronald C. Parker
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June 1, 2020

By email to: rule-comments@sec.gov

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

RE: File No. S7-05-20: Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets

Dear Ms. Countryman:

On behalf of the North American Securities Administrators Association, Inc. ("NASAA"),[1] I am writing in response to U.S. Securities and Exchange Commission (the "SEC" or "Commission") Release No. 33-10763, *Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets* (the "Proposal"),[2] in which the Commission proposes to harmonize certain differences in the rules governing exempt securities offerings.

NASAA has significant concerns with the Proposal. In general, we see it as yet another unnecessary policy choice by the Commission to expand the private securities market to the detriment of the public market. The Commission's stated goal is to facilitate capital formation by reducing complexity and "friction points" in the regulation of exempt offerings.[3] Yet, facilitating

[1] Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

[2] The Proposal is available at https://www.sec.gov/rules/proposed/2020/33-10763.pdf.

[3] Proposal at 10. It should be recognized that certain features of the Proposal would introduce rules that run counter to existing statutory requirements under the authority provided by Section 28 of the Securities Act of 1933 (the "Securities Act"), which allows the Commission to exempt persons, securities, transactions and classes thereof from Securities Act requirements "to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors." 15 U.S.C. § 77z-3. For the reasons explained in this letter, NASAA posits that parts of the Proposal are not consistent with the protection of investors. The Commission

more exempt offerings in the manner proposed will do nothing to promote or otherwise support capital formation in the public markets, and will ultimately have negative consequences for investors. The most likely outcome of the Proposal will be for more issuers to remain private, which will have the deleterious effect of depriving investors in those companies of the benefits of registration.

The types of companies that rely on private offerings are frequently not the sorts of companies in which non-accredited investors should be investing. As NASAA has stated previously, "the lack of transparency and liquidity in the private securities markets makes it ripe for bad actors. In fact, private offerings rank among the most common sources of enforcement actions brought by NASAA's member state securities regulators."[4] Aside from the risks of fraud, investing in private companies is also extremely risky because private issuers fail frequently, their securities are illiquid, and their governing documents often provide little or no protections for the rights of minority shareholders. In the current environment, with the economy itself reeling and vulnerable, investors need safe and transparent investments that have the best chance to build value. Now, perhaps more than at any time since the Great Depression, it is bad public policy to pursue rule changes that aim to encourage greater numbers of investors to look to private investments for financial security.[5]

Also, as NASAA and other commenters have stated repeatedly, the Commission should not pursue its current slate of deregulatory proposals especially in the absence of hard data about the exempt offering marketplace. The Commission has recognized this problem in the context of Regulation D offerings[6] – the largest segment of the exempt offerings market – but has nevertheless allowed it to persist by failing to take steps to gather more data, such as requiring pre-filing and post-closing Form D filings from issuers.[7] A previous Commission proposed to remedy this lack of data in 2013 pursuant to a companion release to amendments to Regulation D implemented in accordance with the Jumpstart Our Business Startups Act. In particular, that

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should therefore consider whether the invocation of exemptive authority is well-founded with respect to rules that can be abused by issuers in the manner described herein.

4 *See* Letter from NASAA President Christopher Gerold Regarding Concept Release on Harmonization of Securities Offering Exemptions, at 3 (Oct. 11, 2019), *available at* https://www.sec.gov/comments/s7-08-19/s70819-6288085-193367.pdf.

5 For this reason, I asked Congress to consider a pause on major SEC rulemakings, especially regarding the current efforts to expand private offerings and the private markets. *See* Statement of NASAA President Christopher Gerold on Behalf of the North American Securities Administrators Association, *Examining the Impacts of the COVID-19 Pandemic on U.S. Capital Markets*, House Financial Services Committee, Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, Roundtable Discussion (May 26, 2020), *available at* https://www.nasaa.org/54987/examining-the-impacts-of-the-covid-19-pandemic-on-u-s-capital-markets/.

6 *See Concept Release on Harmonization of Securities Offering Exemptions*, SEC Release No. 33-10649, at 23 (Jun. 18, 2019), *available at* https://www.sec.gov/rules/concept/2019/33-10649.pdf ("Due to data limitations, it is difficult to draw rigorous conclusions about the extent of fraud in exempt securities offerings."); *id.* at 24 ("Due to data limitations, it is also difficult to draw rigorous conclusions about the average magnitude of investor gains and losses in exempt securities offerings."); *id.* at 36 ("We estimate households and not individuals due to data limitations because the database underlying our analysis measures wealth and income at the household level.").

7 *See* SEC Compliance and Disclosure Interpretation Question 257.07, *available at* https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.

proposal would have required (i) the filing of a Form D in a Rule 506(c) offering before an issuer could engage in general solicitation, (ii) the use of written general solicitation materials in Rule 506(c) offerings, (iii) the submission of written general solicitation materials used in Rule 506(c) offerings to the Commission, and (iv) the filing of a post-closing Form D after completion of an offering.[8] These proposed amendments, unfortunately never adopted, would have provided the Commission with substantially greater visibility over the Regulation D market than it currently possesses. It is not sound to propose major changes to the federal securities laws based on assumptions, and then hope that they will operate as intended. The Commission should not move forward with the Proposal until it at least corrects this perennial problem and can root any rulemaking in objective data.

This letter first sets out our principal concerns with the Proposal, which are in the areas of integration, testing the waters communications, the proposed treatment of "demo days," the harmonization of Regulation A and Regulation D disclosure requirements, and exempt offering and investment limits. We believe these issues require substantial attention and revision if the Commission intends to move forward with the Proposal. We then discuss aspects of the Proposal for which we can offer our support.

I. <u>The Proposed 30-Day Integration Safe Harbor Is Too Short and Would Be Vulnerable to Abuse by Issuers.</u>

The Proposal would replace the existing integration safe harbors with a new safe harbor, proposed Rule 152, which would set forth the Commission's general integration principles and enumerate four specific safe harbor fact patterns.[9] The Commission's purported goal is to provide greater clarity for issuers regarding whether multiple offers would be integrated.[10] NASAA does not object to the goal of harmonizing the SEC's integration regime. However, the proposed 30-day integration safe harbor in proposed Rule 152(b)(1) goes too far. NASAA opposes a 30-day integration safe harbor because we believe that such a brief time period would render the integration doctrine a nullity.[11]

The Proposal would create a blanket 30-day integration safe harbor applicable to all exempt offerings. Any offering made more than 30 calendar days before the commencement of any other offering, or more than 30 calendar days after the termination or completion of any other offering, would not be integrated (provided that, for an exempt offering for which general solicitation is not permitted, purchasers were not solicited through a general solicitation or had a substantive

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8 *See Proposed Rule: Amendments to Regulation D, Form D and Rule 156*, SEC Release No. 33-9416 (Jul. 10, 2013), *available at* https://www.sec.gov/rules/proposed/2013/33-9416.pdf.

9 *See* Proposal at 30.

10 *Id.* at 27.

11 NASAA does not object to the other three integration safe harbors in proposed Rule 152(b)(2)-(4) regarding employee benefit plans and Regulation S offerings, registered offerings after an exempt offering for which general solicitations were not permitted, and exempt offerings conducted pursuant to general solicitations subsequent to other terminated or completed offerings. *See id.* at 46-54.

relationship with the issuer prior to the offering).[12] This change would dramatically truncate existing integration safe harbors, most of which require six months between offerings.

The Proposal's 30-day global integration safe harbor is simply too short. Current integration standards are appropriate for investor protection and provide sufficient capacity for issuers to conduct exempt offerings.[13] Previous Commissions have considered and rejected shortening the safe harbor. In 2007, the Commission (at the behest of the SEC Advisory Committee on Smaller Public Companies) proposed to shorten the integration safe harbor to 90 days. The Advisory Committee suggested a 30-day safe harbor. The Commission rejected this idea as potentially harmful to investors, and its analysis is worth quoting at length (emphasis supplied):

> *The current six-month time frame of the safe harbor in Rule 502(a) provides a substantial time period that has worked well to clearly differentiate two similar offerings and provide time for the market to assimilate the effects of the prior offering. The Advisory Committee has expressed concern, however, that such a long delay could inhibit companies, particularly smaller companies, from meeting their capital needs. We recognize that increased volatility in the capital markets and advances in information technology have changed the landscape of private offerings.* ***We remain concerned, however, that an inappropriately short time frame could allow issuers to undertake serial Rule 506-exempt offerings each month to up to 35 non-accredited investors in reliance on the safe harbor, resulting in unregistered sales to hundreds of non-accredited investors in a year. Such sales could result in large numbers of non-accredited investors failing to receive the protections of Securities Act registration.*** *Our proposal seeks to strike an appropriate balance between the number of non-accredited investors allowed in an offering relying on the integration safe harbor and the non-public nature of that offering. It would be an anomalous result that an issuer could make an offering to hundreds of non-accredited investors in reliance on the integration safe harbor, triggering reporting requirements under the Exchange Act, without a public offering.*[14]

The Commission's previous concern that a 30-day safe harbor will "result[] in unregistered sales to hundreds of non-accredited investors a year" remains equally valid today. A 30-day safe harbor would be just as vulnerable to abuse today as it was when the Commission rejected it previously. Issuers would have tremendous freedom to game the 30-day safe harbor, undermining the

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12 *See id.* at 37.

13 NASAA has advocated for maintaining six-month integration safe harbors previously. *See* Letter from NASAA President Karen Tyler Regarding SEC Release No. 33-8828, at 10-11 (Oct. 26, 2007), *available at* https://www.sec.gov/comments/s7-18-07/s71807-57.pdf.

14 *Revisions of Limited Offering Exemptions in Regulation D*, SEC Release No. 33-8828, at 59 (Aug. 3, 2007), *available at* https://www.sec.gov/rules/proposed/2007/33-8828.pdf.

integration doctrine,[15] because the SEC cannot possibly police compliance with it and investors would have little or no incentive to do so (absent fraud or a material misstatement in the offering) given that their only remedy would be to unwind the transaction pursuant to Securities Act Section 12(a)(1).[16] Commissioner Lee is correct when she predicts the Proposal will result in "a nearly wholesale importation of general solicitation into the private markets."[17] Under proposed Rule 152, the integration doctrine would decline into irrelevance, and the predictable effect would be the uncontrollable inclusion of large numbers of non-accredited investors in exempt offerings.

The integration doctrine is fundamental to securities regulation.[18] It has rightly been viewed as good policy by past Commissions, and it remains good policy today. NASAA is not persuaded that current integration safe harbors impede capital formation. We are also deeply concerned about the risks to investors and the overall public markets if the Commission were to adopt a blanket 30-day integration safe harbor as outlined in the Proposal. An issuer who sells securities to a large number of non-accredited investors in a short timeframe should be required to register those securities in order to provide investors the protections of the registration process as Congress and state legislatures intended.[19]

II. <u>The General Prohibition Against Testing the Waters in Exempt Offerings Is an Important Protection that Should Not be Abandoned</u>.

NASAA also opposes proposed Rule 241 and its expansion of "testing the waters"[20] authority to issuers of exempt offerings. Last year, the Commission proposed Rule 163B under the Securities Act.[21] Rule 163B would allow issuers in registered offerings to engage in testing the waters communications with qualified institutional buyers (as defined in Rule 144A) and

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[15] This will be particularly true if the Commission opens the floodgates for issuers to test-the-waters by adopting proposed Rule 241, discussed *infra*.

[16] 15 U.S.C. § 77l(a)(1).

[17] *See* Commissioner Allison Herren Lee, *Statement on Proposed Amendments to the Exempt Offering Framework*, text accompanying n. 10 (Mar. 4, 2020), *available at* https://www.sec.gov/news/public-statement/lee-statement-proposed-amendments-exempt-offering-framework. And, as Commissioner Lee pointed out, the Proposal is not even internally consistent on what standards will apply when an issuer conducts an exempt offering that prohibits general solicitation (*e.g.*, a Rule 506(b) offering) after conducting an exempt offering that allows for general solicitation (*e.g.*, a Rule 506(c) offering). *See id.*, text accompanying n. 7.

[18] *See* Proposal at 23, n. 48 (citing SEC Release No. 33-97 (Dec. 28, 1933); *Section 3(a)(11) Exemption for Local Offerings*, SEC Release No. 33-4434 (Dec. 6, 1961); and *Non-Public Offering Exemption*, SEC Release No. 33-4552 (Nov. 6, 1962)).

[19] *See SEC v. Ralston Purina Co.*, 346 U.S. 119, 120 (1953).

[20] "Testing the waters" refers to communications between a prospective securities issuer and securities investors prior to the issuer's having undertaken to make a securities offering in order for the issuer to assess the potential level of investor interest in a potential securities offering. Such communications generally would be prohibited by Section 5 of the Securities Act absent an SEC exemptive rule to permit the communications.

[21] *See Solicitations of Interest Prior to a Registered Public Offering*, SEC Release No. 33-10607 (Feb. 19, 2019), *available at* https://www.sec.gov/rules/proposed/2019/33-10607.pdf.

institutional accredited investors (as set forth in Rule 501 under Regulation D).[22] In effect, Rule 163B would extend to all issuers of registered offerings the same flexibility to test the waters that was previously afforded only to emerging growth companies.[23] NASAA did not oppose Rule 163B, and in September 2019 the Commission adopted the new rule.[24]

With the ink barely dry on new Rule 163B, though, the Commission now seeks to further expand instances of testing the waters through proposed Rule 241. Rule 241, which is based on the testing the waters provisions in Regulation A, would permit issuers to communicate about a prospective exempt offering with *any* investor.[25] To take advantage of proposed Rule 241, an issuer would merely have to provide investors a four-part disclaimer.[26] The Proposal asserts that this would be consistent with investor protection because proposed Rule 241 would not affect the availability of subsequent securities exemptions, and the general antifraud provisions of the securities laws would still apply.[27]

NASAA opposes proposed Rule 241 for the same reasons we oppose the 30-day integration safe harbor in proposed Rule 152: the new standard would not increase investor protection, and it would be evaded or exploited easily. Both proposed rules represent a diminution of the types of prophylactic measures built into the securities laws for investor protection. The antifraud provisions of the federal securities laws are not sufficient in and of themselves to protect investors. Congress included prophylactic measures (such as Section 5 of the Securities Act) to prevent fraud and forestall abusive practices.[28] Congress did not want investors to have to put their trust in securities issuers and rely on *ex post* antifraud actions in the event of issuer malfeasance. Further, given that the Commission's Division of Enforcement has been forced to allocate its resources carefully due to hiring freezes and a multi-year reduction in staff,[29] the Commission should understand that it may not be able to police a surge in fraudulent issuer activity. The Commission should therefore not weaken the longstanding prohibitions against testing the waters that undergird Section 5.[30]

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22 *See id.* at 5, 74.

23 *See id.* at 5-6. Issuers can also test the waters before making a Regulation A offering pursuant to Rule 255 thereof. *See* 17 C.F.R. § 230.255.

24 *See Solicitations of Interest Prior to a Registered Public Offering*, SEC Release No. 33-10699 (Sep. 25, 2019), *available at* https://www.sec.gov/rules/final/2019/33-10699.pdf.

25 Proposal at 76.

26 *See id.* at 73.

27 *Id.* at 74-75.

28 *See, e.g., SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963) ("A fundamental purpose [of the federal securities laws] was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.").

29 *See* SEC, Division of Enforcement, *2019 Annual Report*, at 22 (Nov. 6, 2019), *available at* https://www.sec.gov/files/enforcement-annual-report-2019.pdf.

30 NASAA of course would oppose any potential preemption of state regulatory authority with respect to the Commission's adoption of Rule 241. NASAA appreciates that the Commission has no intention of seeking to

III. **The Proposed "Demo Day" Rule Is Not Sufficiently Limited to Prevent General Solicitations or General Advertisements.**

As the Commission describes it, proposed Rule 148 seeks to balance issuer access and investor protection with respect to "demo days" and similar sorts of seminars and meetings by limiting the types of institutions that can hold such events, the manner in which event sponsors can be compensated, and the content that can be delivered.[31] Each of these aspects would need to be controlled more meaningfully than proposed in order to avoid concerns that such events would operate as acts of general solicitation or general advertisement.

First, the inclusion of "nonprofit organizations," "incubators," and "accelerators" in the proposed rule could be abused. As currently proposed, such entities could be affiliated with an issuer and still fall within the rule. If so, entities could be created under the proposed rule that are designed by issuers specifically to attract non-accredited investors. An amendment to the proposed rule that prohibits any form of control or affiliation with an issuer, or group of issuers, is therefore advisable.

Further, limiting the proposed compensation restrictions to "compensation for making introductions" and "compensation with respect to the event that would require registration of the sponsor as a broker or dealer," as proposed, again does not foreclose the creation or operation of entities designed to attract investors to private issuers, but who are compensated indirectly by issuers for doing so.[32] The questions in Request for Comment 19 recognize this possibility,[33] and the proposed rule should accordingly be revised to prohibit entities whose sole or primary purpose is to attract investors to private issuers.

Last, it is difficult to understand how an issuer does not in fact make an offer in such an event when it is allowed to (i) indicate that it is planning to make an offer, (ii) specify the type and amount of securities being offered, and (iii) describe the intended use of proceeds. There is nothing left for the investor to do but wait a short time to receive a direct solicitation. The Commission asserts that a communication may not be a general solicitation when an issuer engages in direct contact "outside of a public offering effort."[34] Yet, the amount of information permitted by the proposed rule, coupled with situations in which the Commission admits that it is "impractical for the organizer of the event to limit participation,"[35] can act precisely as a public offering effort. As proposed, it would be impossible to enforce such a fuzzy distinction between permitted and prohibited offer communications.

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preempt state registration or qualification requirements that may apply to offers made pursuant to Rule 241. *See* Proposal at 77.

[31] *See id.* at 65-68.

[32] *See id.* at 300 (text of proposed Rule 148).

[33] *See id.* at 69.

[34] *Id.* at 68.

[35] *See id.* at 65.

It is also unrealistic to expect that eager issuers will not go beyond the loosely prescribed bounds of the proposed rule, either in their presentations or in discussions that take place at an event. If a broad-based invitation to a demo day event brings non-accredited investors into direct contact with issuers who detail their offerings, that should be regarded as a general solicitation. The Proposal should be amended to specify that an issuer may provide factual business information about itself but issuers may not discuss any potential securities offers. This prophylactic measure would help ensure that a demo day event cannot become a *de facto* general solicitation. Another constructive limitation, as suggested in the questions posed in Request for Comment 21,[36] is to state that a pre-existing relationship cannot be based solely on an event in which an issuer has both described its business and conditioned attendees to anticipate an upcoming offer.

IV. The Commission Should Not Harmonize Disclosure Standards Under Regulation D and Regulation A Downward but Should Instead Collect More Data Prior to Undertaking Substantive Rulemakings in this Area.

The next part of the Proposal would seek to harmonize the differing disclosure standards between Regulation D and Regulation A.[37] Many of these proposed changes would be useful and pose no material risk to investors. NASAA cannot, however, support the proposed easing of financial disclosure obligations under Regulation D Rule 502.

Rule 502(b)(2)(B) requires issuers that do not file reports with the Commission pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") to provide certain financial disclosures to any non-accredited investor participating in a Rule 506(b) offering. Rule 502(b)(2)(B) sets forth a graduated scale of increasing financial disclosures as the size of the Rule 506(b) offering increases. At the top level, for offerings over $7.5 million, an issuer must provide non-accredited investors with "financial statement[s] as would be required in a registration statement" filed with the Commission.[38] The Proposal seeks to amend Rule 502(b)(2)(B) to align its disclosure obligations with those of Regulation A Tier 1 which, notably, can be up to $20 million and do not require audited financial statements. The Proposal argues that aligning these standards would expand investment opportunities for non-accredited investors.[39]

Setting aside for a moment whether it is good public policy to encourage greater non-accredited investor participation in unregistered offerings, lessening the financial disclosure obligations of smaller Rule 506(b) offerings to come into line with standards under Regulation A Tier 1 would be a step in the wrong direction. Rule 506(b) offerings differ from Tier 1 offerings in material ways. Most notably, Regulation A Tier 1 offering circulars generally must be filed with, and be subject to review and qualification by, the staff of the SEC and the state securities regulator in each state in which the securities will be offered. In contrast, Rule 506(b) offerings proceed with no regulatory review, and the only document filed with the SEC or with a state is a

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36 *See id.* at 70.

37 *See id.* at 92-114.

38 17 C.F.R. § 230.502(b)(2)(B)(3).

39 Proposal at 94-95.

short notice of the offering on a Form D. It is thus entirely appropriate for Rule 502(b)(2)(B) to require audited financial statements in Rule 506(b) offerings over $7.5 million (and for Rule 502(b)(1) to require audited financial statements if any sales are made to non-accredited investors). If the Commission is interested in aligning disclosure standards, the Commission should heighten the standards under Regulation A Tier 1, not lower the standards under Regulation D.

What is more, the proposed rule change is unnecessary because the market is not lacking in Rule 506(b) offerings. Approximately $1.5 trillion was raised in 2018 through Rule 506(b) offerings, by far the largest exempt offering pathway.[40] Given this, NASAA is skeptical of claims that the financial statement requirements in Rule 502(b) are overly burdensome.[41] Clearly, this is not the case for many private issuers.

V. <u>There Is No Need to Raise Offering and Investment Limits Because Issuers Are Nowhere Near Utilizing the Capacity That Already Exists</u>.

The Proposal next would raise offering and investment limits of certain exemptions under Regulation A, Regulation Crowdfunding, and Regulation D Rule 504.[42] NASAA accepts that these pathways are used less frequently than Regulation D Rule 506. Our concerns with the Commission's agenda to expand the private markets aside, it is doubtful that raising the offering and investment limit ceilings would lead to greater usage of these exemptions.[43]

For example, Regulation A Tier 2 is not underutilized because the amount of capital that can be raised under the exemption is too small. The current ceiling, $50 million, is quite ample. Evidence indicates that Regulation A Tier 2 is underutilized because the issuers that use it are highly speculative and investors are wisely steering clear.[44] The staff of the SEC's Division of Corporation Finance researched Regulation A offerings and reported this past March that current offering limits are barely being scratched. The staff found that:

> *A typical Regulation A issuer sought to offer amounts that were substantially below existing offering limits. Reported proceeds were significantly smaller than the amounts sought and the existing offering limits, and only 10% of issuers reported*

[40] *See Concept Release*, *supra* note 6, at 19.

[41] *See* Proposal at 98-99.

[42] *See id.* at 114 (stating that out of the $2.9 trillion raised through exempt offerings in 2018, less than $3 billion – or 0.1% – was raised through Regulation A, crowdfunding or Rule 504).

[43] For example, we are doubtful that increasing the Rule 504 offering limit to $10 million from $5 million as the Commission proposes will increase usage of this exemption. *See* Proposal at 122. Offerings over $5 million could no longer rely on exemptive authority of Section 3(b)(1) of the Securities Act but rather will have to comply with Section 3(b)(2), which carries with it obligations including mandatory filing of audited financial statements with the Commission. *See* 15 U.S.C. § 77c(b)(2). We suspect issuers will balk at the additional obligations necessitated by Section 3(b)(2).

[44] *See, e.g.*, Bill Alpert *et al*., *Most Mini-IPOs Fail the Market Test*, Barron's (Feb. 13, 2018), *available at* https://www.barrons.com/articles/most-mini-ipos-fail-the-market-test-1518526753 (finding that "the average Reg A+ stock fell 40% in the six months after its mini-IPO" and "most Reg A+ businesses haven't gotten beyond the startup phase known as the pipedream").

> *proceeds that in the aggregate (across the entire June 2015–December 2019 period) reached the respective 12-month offering limit.*[45]

It is axiomatic that raising the Tier 2 offering limits would allow a few issuers to raise a bit more capital through their offerings. However, this change would be detrimental to any retail investors that invest in these offerings. These offerings have often been made by companies that provide little corporate governance protections to shareholders and generally perform poorly. (As shown by the SEC staff's study discussed above, only 47% of Regulation A issuers reported receiving revenues and only 21% had positive net income.[46]) Given this track record, an issuer that believes it can use more than $50 million responsibly, and generate positive returns, should undertake a public offering and convince investors through full disclosure that it is ready do so.

Raising the offering limit is the wrong approach to increasing the use of Regulation A Tier 2. Rather, the Commission should instead focus its attention on measures that would make the issuers of these securities more attractive to and safe for investors. NASAA has previously described measures that would achieve this, notably strengthening corporate governance and disclosure obligations and rescinding preemption of state securities regulation to increase the regulatory oversight of these companies.[47]

VI. NASAA Supports the Proposed Amendments to the Regulation Crowdfunding and Regulation A Eligibility Restrictions with Revisions.

A. The Proposal to Allow Crowdfunding Through Special Purpose Vehicles Should Be Revised to Strengthen and Clarify Investor Rights.

Proposed Rule 3a-9 under the Investment Company Act of 1940 contemplates the use of an exempted investment company with limitations designed to protect investors and ensure their voting rights as if they were direct investors in a crowdfunding issuer.[48] While NASAA does not

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[45] *See Report to the Commission - Regulation A Lookback Study and Offering Limit Review Analysis*, at 12-13 (Mar. 4, 2020), *available at* https://www.sec.gov/files/regulationa-2020.pdf.

[46] *See id.* at 14. Further, given that much of the evident lack of strength for Regulation A Tier 2 offerings is due to the poor performance of the issuers and features in the offerings that make them unattractive to investors, NASAA believes it would not make sense to preempt secondary sales of such offerings. *See* Proposal at 137, Question 65. Doing so would do nothing to address the lackluster quality of the offerings themselves and it would remove a level of oversight that inures to the protection of investors either invested in, or contemplating investing in, these issuers. Likewise, there is no reason evident or offered by the Commission to suggest that preemption of secondary trading in Regulation Crowdfunding offerings would enhance their attractiveness. Indeed, the issues identified by the Commission are features of the offering mechanism that make them unattractive to issuers, not investors.

[47] *See, e.g.*, Letter from NASAA President Christopher Gerold, *supra* note 4; Letter from NASAA President Andrea Seidt Regarding Proposed Rule Amendments for Small and Additional Issues Exemptions (Mar. 24, 2014), *available at* https://www.sec.gov/comments/s7-11-13/s71113-75.pdf.

[48] Given that the driving concern behind this proposal is the difficulties that private companies face when dealing with multitudes of small investors, it would seem that a micro-offering exemption would exacerbate such problems and is therefore not advisable. *See* Proposal at 136-37, Question 64. However, NASAA would not support limitations on disclosures associated with small offerings.

oppose the concept of special purpose vehicles ("SPVs"), certain features of the proposed rule could frustrate investor protection and participation goals. In particular, the Proposal states that "any compensation paid to any person operating the crowdfunding vehicle must be paid solely by the crowdfunding issuer."[49] If so, the SPV's manager would be an employee or agent of the issuer, which would present a conflict of interest. This concern is exacerbated by the fact that the Proposal would not require the SPV manager to be a registered investment adviser. A registered investment adviser has fiduciary obligations to its investors. As proposed, the SPV manager would not. The Commission should revise the proposed rule either to require the SPV to be managed by a registered investment adviser or to require a fiduciary relationship between the SPV's manager and investors.

Further, proposed rule 3a-9 would require the SPV to seek investor input only for matters of voting the issuer's securities and participating in tender or exchange offers or similar transactions. It is not clear whether the SPV could ignore investor calls for such things as engaging in derivative litigation, participating in class actions, and offering proxy proposals. While proposed rule 3a-9(a)(9) would allow investors to direct the SPV to assert investor rights, it does not obligate the SPV to take specific actions on behalf of its investors, nor does it specify what the SPV will or will not do in order to assert investor rights. Given that the SPV's manager will be paid by the issuer, it is likely that the SPV will do only what is required. The current proposal is too limited with respect to the specific actions required, and too ambiguous with respect to what the SPV will do to assert investor rights. The Commission should therefore revise the proposed rule to fully articulate what actions the SPV will take on behalf of its investors. Alternatively, the Commission could add a principles-based rule that would require the SPV to take all actions directed by its investors collectively.

Last, while the proposed rule would require the SPV to follow investor directions regarding tender or exchange offers or similar transactions, the consequences of such events on the SPV itself are not clear. For instance, if the crowdfunding issuer became publicly-listed, it is not clear that the SPV investors would receive publicly-listed shares directly, or would instead remain investors in the SPV. In NASAA's view, once an issuer becomes a public company, the concerns behind creating an SPV, such as managing capitalization tables and remaining under registration thresholds, cease to exist. Likewise, if an issuer is acquired in a tender or exchange offer, the SPV will hold either cash or the acquirer's securities which again obviates the purpose of the SPV. The Commission should revise the proposed rule to clarify that such liquidity or exchange events would lead to the dissolution of the SPV.

B. The Proposals to Regulate Crowdfunding Eligible Securities, Extend Regulation A Ineligibility Restrictions for Delinquent Exchange Act Filers, and Extend Certain Bad Actor Disqualification Provisions Are Sound.

NASAA agrees with the Commission that offerings under Regulation Crowdfunding should be limited to equity securities, debt securities, and securities convertible or exchangeable to equity interests, including any guarantees of such securities. NASAA agrees that non-traditional securities, such as (but not limited to) Simple Agreements for Future Equity, "could result in harm

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[49] *Id.* at 147.

to investors who may face challenges in analyzing and valuing such securities, or who may be confused by the descriptions of such securities on the funding portals."[50] Implicit in this portion of the Proposal is the recognition that Regulation Crowdfunding is the province of retail investors and traditional securities are the safest products to offer to them, especially in the context of these highly speculative investments. More generally, NASAA encourages the Commission to conclude that non-accredited investors should not be exposed to complex products that are more appropriate for accredited and institutional investors, or to innovative products whose features are untested and whose risks are not fully understood by either investors or regulators. Such products are commonly found in private offerings, and the same caution behind this portion of the Proposal should apply to the Commission's thinking about the private markets generally.

Also, the Commission's decision to extend ineligibility restrictions to would-be Regulation A issuers who are delinquent in their periodic filings is a logical extension of the requirements of Rule 257 under the Securities Act for issuers who, as a consequence of a Regulation A offering, become subject to periodic reporting requirements. By helping to make clear that issuers are expected to behave as public companies once they enter the public markets, even through the means of exempt offerings, the Commission is at least partly addressing the concern that the current proposals will cause even substantial companies to remain in the private markets permanently.

Finally, the Commission's proposal to harmonize the bad actor disqualification provisions in Rule 506(d) of Regulation D, Rule 262(a) of Regulation A, and Rule 503(a) of Regulation Crowdfunding by adjusting the look-back requirements in Regulation A and Regulation Crowdfunding to include the time of sale in addition to the time of filing is a positive enhancement. NASAA appreciates the Commission's effort to capture a wider array of circumstances under which disqualification events can occur, both during the offering process and in between filings.

VII. Conclusion

NASAA is unable to support much of the Proposal in its current form because, as proposed, it is designed to expand the private markets without any attempt to gain further information about these markets, it would leave the private markets open to greater levels of issuer abuse,[51] and it does nothing to support the public market. In broad brush, we see the Proposal as an unnecessary and potentially harmful expansion of the private securities market to the detriment of the public

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[50] *Id.* at 156-57.

[51] Large private offering frauds include actions against the Woodbridge Group of Companies, Inc., in which the SEC charged the defendants with a $1.2 billion offering fraud (*see* SEC Press Release 2017-235, SEC Charges Operators of $1.2 Billion Ponzi Scheme Targeting Main Street Investors (Dec. 21, 2017)); Medical Capital Holdings, Inc., in which investors lost hundreds of millions of dollars (*see* Bruce Kelly, MedCap Trustee to Pay Investors $114m, Investment News (Apr. 29, 2013)); and Provident Royalties LLC, in which the SEC obtained an asset freeze of $485 million (*see* SEC Litigation Release No. 21118, SEC Obtains Asset Freeze in $485 Million Nationwide Offering Fraud (Jul. 7, 2009)). And, in an enforcement action just last week, the Massachusetts Securities Division filed fraud charges against GPB Capital and related respondents in connection with allegedly fraudulent private placements that harmed dozens of Massachusetts residents. *See In re GPB Capital Holdings et al.*, Docket No. E-2018-0100 (May 27, 2020), *available at* https://www.sec.state.ma.us/sct/current/sctgpb/2020-5-27-MSD-GPB-Complaint-E-2018-0100.pdf.

market. As explained above, our concerns include the Proposal's curbing of the integration doctrine, its expansion of permissible testing the waters communications, its lax treatment of "demo days," its downward harmonization of Regulation A and Regulation D disclosure standards, and its unnecessary expansion of exempt offering and investment limits. We believe these issues all require substantial revision if the Commission moves forward with the Proposal.

Thank you for considering these views. We look forward to continuing to work with the SEC on our shared mission of protecting investors. Should you have questions, please contact either the undersigned or NASAA's Executive Director, Joseph Brady, at (202) 737-0900.

Sincerely,

Christopher Gerold
NASAA President
Chief, New Jersey Bureau of Securities

Principles for Responsible Investment

February 03, 2020

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

File Number: S7-23-19: Proposed Rule: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8

Dear Ms. Countryman:

The Principles for Responsible Investment ("the PRI") welcomes the opportunity to submit this letter in response to the SEC's recently proposed "Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8" ("Proposed Rule").

The PRI is the world's leading initiative on responsible investment. It works to understand the investment implications of environmental, social and governance (ESG) factors and to support its international network of 2,800 investor signatories in incorporating these factors into their investment and ownership decisions. Launched in New York in 2006, the PRI's signatories manage over $90 trillion in AUM.[1] The US is the PRI's largest market, with over 500 signatories investing over $45 trillion in AUM.[2]

The PRI's signatories believe integrating ESG factors has become a necessary part of investment, as it is critical for the promotion of long-term shareholder value. In the context of market volatility, climate change and regulatory intervention, ESG factors offer an expanded set of tools to address unmet investment industry needs in accordance with investors' fiduciary duties.

SUMMARY

The PRI's diverse signatory base believes it is critical for corporate management to be accountable to those who provide them capital: their shareholders. Signatories commit to a set of six Principles, the second of which states that they "will be active owners and incorporate ESG issues into our ownership policies and practices."[3] While they employ a variety of active ownership strategies,

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[1] As of October 01, 2019.

[2] As of October 01, 2019.

[3] Principles for Responsible Investment (PRI), *What are the Principles of Responsible Investment?* available at: https://www.unpri.org/pri/an-introduction-to-responsible-investment/what-are-the-principles-for-responsible-investment.

signatories share the view that the shareholder resolution process has been critical to active ownership — and the basic functioning of the investment intermediation chain.

The PRI believes, as explained in this letter, that the basis for the SEC's Proposed Rule is substantially at odds with empirical evidence — and that the rule would significantly impede the accountability of management to their shareholders. Although the PRI believes the rule as a whole is unnecessary, this letter focuses on the changes to the resubmission thresholds and so-called "momentum" requirements, which would have the most harmful effect on its signatories' ability to bring and sustain resolutions. **Accordingly, the PRI recommends that:**

- The proposed changes to the resubmission thresholds be removed, particularly the Proposed Rule's momentum requirement.
- Should there be a future rulemaking, the SEC should carefully consider this data and substantially revise its economic analysis, in particular considering the implications of the Proposed Rule on the ability of investors to hold management accountable.

This comment letter is organized as follows.

In Section I, the PRI presents the results of an original economic analysis (relying on publicly available data) of shareholder resolutions[4] that appeared on proxy filings from 2006 through 2018, which is summarized below (**pages 3-9**):

1. Under the Proposed Rule, hundreds of resubmitted shareholder resolutions would now fail to make the ballot ("excluded"), and hundreds of *successful* resolutions would also be excluded.
    - 399 resubmitted proposals would be excluded under the Proposed Rule, including 172 environmental and social proposals.
    - 181 proposals that received a 20% vote, 87 proposals that received a 30% vote, and 22 proposals that received a 40% vote would be excluded.

2. Shareholder resolutions see substantial variance in support over time, undercutting a key premise of the Proposed Rule.
    - 244 resubmitted proposals gain 10 percentage points or more on resubmission.
    - 66 resubmitted proposals gain 20 percentage points or more on resubmission.

3. The Proposed Rule is unnecessary, as resolutions with lower vote percentages are already being taken off the ballot, which the SEC fails to consider.
    - Proposals that earned 10% of the vote had around a 75% chance of not appearing on the ballot again.

[4] A shareholder resolution or proposal is a recommendation or requirement that the company and/or its board of directors take action, which shareholder's present at a meeting of the company's shareholders. 17 C.F.R. § 240.14a-8.

4. The Proposed Rule would alter US corporate governance by substantially locking out smaller and mid-sized investors from influencing outcomes of votes, increasingly requiring them to persuade larger investors for resolutions to succeed.
    - 227 excluded proposals under the Proposed Rule are one large asset manager away from a 20% vote; 162 excluded proposals are one large asset manager away from 30% vote; 80 excluded proposals are one large asset manager away from a 40% vote.

In Section II, the PRI explains how the Proposed Rule's stated benefits are dwarfed by the costs to investors in reduced monitoring of management (**pages 9-10**):

1. The Proposed Rule's analysis of costs overestimates the costs to companies of engaging with shareholder resolutions and fails to provide evidence that those costs are significant.
2. The Proposed Rule underestimates the benefits to investors of increased monitoring of management and fails to consider that such monitoring often enhances long-term value.

In Section III, the PRI outlines other implications of the Proposed Rule for corporate governance (**pages 10-13**):

1. The SEC has historically used shareholder resolutions as an important measure of investor interest that has led to the development of landmark transparency rules and corporate reforms. As a result, under the Proposed Rule, the SEC and issuers alike will lose an important means of gauging investor interest.
2. Shareholder resolutions have yielded a tremendous amount of important information and action at companies. Increasing the shareholder resolution thresholds would be a major blow to ESG integration and long-term value at US companies.

I. THE PRI'S ORIGINAL ECONOMIC ANALYSIS ON THE EFFECTS OF THE PROPOSED RULE

1. Under the Proposed Rule, Hundreds of Resubmitted Shareholder Resolutions Would Now Be Excluded

The SEC's proposed changes to the 14a-8 thresholds would:

- Raise the current resubmission thresholds of 3%, 6% and 10% for matters voted on once, twice or three or more times in the last five years, respectively, with thresholds of 5%, 15% and 25%, respectively; and
- Add a new provision that would allow for exclusion of a proposal that has been previously voted on three or more times in the last five years, notwithstanding having received at least 25% of the votes cast on its most recent submission, if the proposal (i) received less than

50% of the votes cast and (ii) experienced a decline in shareholder support of 10% or more ("momentum" rule) compared to the immediately preceding vote.[5]

In order to understand the effects of these changes on its signatories, who often bring shareholder resolutions at US companies, the PRI analyzed all proposals that appeared on proxy filings from 2006 through 2018. Of 6,145 unique proposals, 1,579 were resubmitted at least once. Under the Proposed Rule, a significant number of those resubmitted resolutions would be excluded by the new resubmission thresholds and momentum requirements[6]:

- 399 resubmitted resolutions would be excluded under the Proposed Rule.

Examples of these excluded resolutions include:

- A proposal at General Electric to require an independent Board Chairman. This proposal would have been excluded after 2016 and 2017 for failing to reach 25%:

Year	Vote %
2012	22.4
2013	24.4
2016	23.3
2017	24.3
2018	41.2

- A proposal at PACCAR, Inc. to require a majority vote for the election of directors. This proposal would have been excluded after 2009 due to the proposed momentum rule:

Year	Vote %
2006	32.1
2007	41.2
2008	40.1
2009	32.7
2010	44.4
2011	44.3

Of all resubmitted *environmental or social* resolutions put to a vote within the preceding three years, 172 resolutions would be excluded under the Proposed Rule. Examples of these resolutions include:

- A proposal at Wyeth Corporation to require a report on political contributions. This proposal would be excluded after 2008 due to the proposed momentum rule:

Year	Vote %

[5] Proposed Rule at 179.

[6] Includes resolutions put to a vote within the preceding three years. *See* Proposed Rule at 9 (raising thresholds for resolutions "if the matter was voted on at least once in the last three years . . . ").

2005	8.0
2006	29.0
2007	32.3
2008	27.4
2009	34.3

- A proposal at Charles Schwab to prepare an employment diversity report. This proposal would be excluded after 2016 for failing to reach 25%:

Year	Vote %
2014	20.3
2015	21.1
2016	24.3
2017	25.9
2018	35.8

- A proposal at Tyson Foods to require a report on water pollution prevention measures. Although this proposal saw improvement over time, under the Proposed Rule it would be excluded after 2015 for not reaching 15%, and after 2016 for not reaching 25%:

Year	Vote %
2010	10.0
2015	11.1
2016	12.1
2018	15.8

2. Under the Proposed Rule, Hundreds of *Successful* Resolutions Would Now Be Excluded

Part of the stated rationale for the Proposed Rule is that unpopular proposals may be less likely to gain support over time, imposing certain costs on management and the broader shareholder base. As the Proposed Rule states in response to reviewing comments from the SEC's 2018 Proxy Roundtable:

> [We] are concerned that the current resubmission thresholds may allow proposals that have not received widespread support from a company's shareholders to be resubmitted — in some cases year after year — with little or no indication that support for the proposal will meaningfully increase or that the proposal ultimately will obtain majority support.

However, the PRI's analysis finds that a sizeable number of proposals that received substantial support among shareholders would now be excluded:

- 181 resolutions that received a 20% vote would be excluded.

- 87 resolutions that received a 30% vote would be excluded.
- 22 resolutions that received a 40% vote would be excluded.
- 6 proposals that received a 50% vote would be excluded.

An example of these excluded resolutions includes:

- A proposal at Anadarko Petroleum Corporation to Amend EEO Policy to Prohibit Discrimination based on Sexual Orientation and Gender Identity. This proposal would have been removed after 2011 due to the proposed momentum rule:

Year	Vote %
2008	9.7
2009	38.0
2010	39.3
2011	33.6
2012	43.2

In the above analysis, the PRI defines "success" with various metrics (20%, 30%, 40%, and 50% votes). This is contrary to the SEC, which sets the very high bar of 50% as the sole measure of success, a standard to our knowledge that has no legal import, as shareholder resolutions are precatory. The SEC's 50% marker also makes the impact of the rule seem smaller than it actually is, because fewer resolutions reach 50% than resolutions than less-than-majority votes. The PRI includes multiple metrics because shareholder proponents often begin to engage in negotiations with management at vote percentages well below 50%.

3. Shareholder Resolutions See Substantial Variance in Support Over Time, Undercutting a Key Premise of the Proposed Rule

In explaining its rationale for the Proposed Rule, the SEC speculates that resolutions that do not see an increase in support upon resubmission are unlikely to be successful later:

> If a proposal fails to generate meaningful support on its first submission, and is unable to generate significantly increased support upon resubmission, it is doubtful that the proposal will earn the support of a majority of shareholders in the near term or without a significant change in circumstances.

Shareholder resolutions in fact see substantial *variations* in support over their lifetime. While resubmitted proposals on average receive 0.0% improvement in support and 51% of resolutions gain vote share between resubmissions, these averages mask significant heterogeneity:

- 244 resubmitted resolutions gain 10 percentage points or more on resubmission.
- 66 resubmitted resolutions gain 20 percentage points or more on resubmission.
- Proposals that obtain over 50% vote (other than on their first time submitted) average 6.6 percentage points gained from the previous year.

In other words, resolutions that were successful on their second-or-later try tend to experience notable gains in support over time. The Proposed Rule inhibits these natural dynamics of resolutions by limiting proposals that do not gain strong early support – or those that do gain strong early support but experience a small dip under the "momentum rule." As a result, under the Proposed Rule, many resolutions would be excluded that would have eventually gained support. The corollary is also true under the PRI's analysis: many proposals lose support on resubmission. As discussed below this letter, a powerful mechanism already exists in the market for removing proposals that receive less support: self-removal.

This is not a particularly surprising result. As the PRI has previously noted to the SEC, investors incorporate their views on shareholder resolutions over time; support in year 1 is not determinative of support in years 2 or 3.[7] This is in contrast to the SEC's stated rationale for its rule that resolutions that do not generate support in their early stages may be less likely to see gains over their life cycles.

4. The Proposed Rule Is Unnecessary, as Resolutions with Lower Vote Percentages are Already Being Taken Off the Ballot, Which the SEC Fails to Consider

The SEC explains the need for its regulatory intervention as updating thresholds that are no longer sorting popular proposals from less popular ones:

> Nevertheless, we are concerned that thresholds of 3, 6, and 10% may not demonstrate sufficient shareholder support to warrant resubmission, or adequately distinguish between proposals that ultimately are more likely to obtain majority support upon resubmission and those that are not. [. . .]
>
> Consequently, we are concerned that the current thresholds may not be functioning effectively to alleviate companies and their shareholders of the obligation to consider, and spend resources on, matters that have previously been voted on and rejected by shareholders without sufficient indication that a proposal will gain traction among the broader shareholder base in the near future.[8]

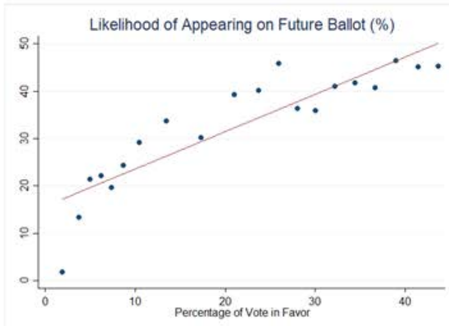
In fact, the PRI finds that the existing thresholds allow the "market" for shareholder resolutions to self-sort. Without the Proposed Rule in effect, proposals that received lower vote percentages tend to be removed from the ballot on their own. The graph below shows proposals from prior to 2018 that had less than 50% of the vote, demonstrating:

- Resolutions that performed well were very likely to appear on the ballot again, while those that performed less well were highly likely to be removed from the ballot. Proposals that earned around 10% of the vote had around a 75% chance of not appearing on the ballot again.

[7] Principles for Responsible Investment, Comment on Rule S7-23-19 (Dec. 12, 2019) available at: https://www.sec.gov/comments/s7-23-19/s72319-6535900-200526.pdf.

[8] Proposed Rule at 49.

- In total, every 10 percentage points of additional support makes a proposal 6.9 percentage points more likely to stay on the ballot.[9]



The SEC's stated rationale for the Proposed Rule is that the existing thresholds do not "adequately distinguish between proposals that ultimately are more likely to obtain majority support upon resubmission and those that are not."[10] But proposals that obtain lower vote percentages are already less likely to reappear in subsequent years under the status quo. In other words: the market is already self-sorting such proposals without the SEC's proposed regulatory intervention.

5. The Proposed Rule Would Alter US Corporate Governance, Locking Out Smaller and Mid-Sized Investors from Swaying Outcomes on Resolutions

Shareholder resolutions have generally always been filed by investors with smaller holdings as opposed to the largest asset managers.[11] Under the Proposed Rule, however, the largest investors would increasingly become necessary for a given resolution's ability to succeed – making it far less likely that smaller investors could influence the outcome of a given resolution. The PRI finds that hundreds of resolutions that would be excluded under the Proposed Rule would now need the support of a single large asset manager (defined below as the companies' largest single blockholder) to survive:

- 227 resolutions that would be excluded under the Proposed Rule are just one large asset manager away from a 20% vote.

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[9] t-stat 18.90.

[10] Proposed Rule at 49.

[11] *See* Vanguard Investment Stewardship Commentary, *What We Do. How We Do It. Why It Matters.* (April 2019) ("We don't [n]ominate directors or seek board seats, submit shareholder proposals . . . ") available at: https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/what_how_why.pdf; *see also* BlackRock, *The Investment Stewardship Ecosystem* (July 24, 2018) ("BlackRock has *never* initiated a shareholder proposal on any company's proxy statement . . . ") available at: https://corpgov.law.harvard.edu/2018/07/24/the-investment-stewardship-ecosystem/.

- 162 resolutions that would be excluded are just one large asset manager away from a 30% vote.
- 80 resolutions that would be excluded are just one large asset manager away from a 40% vote.
- 25 resolutions that would be excluded are one large asset manager away from a 50% vote.
- 180 resolutions (50.5%) of the 356 excluded resolutions for which we have institutional ownership data are within one large asset manager away not being excluded.[12]

More than ever, a proponent would now have to convince large institutional investors of a resolution's merits for it to have a chance of being sustained. While large investors have made important strides in ESG integration and stewardship, the Proposed Rule will have major implications for US corporate governance that the SEC appears not to have considered. Accordingly, the SEC should carefully weigh the implications of the rule for smaller and medium-sized investors' ability to hold corporate management accountable.

II. THE RULE'S STATED BENEFITS ARE DWARFED BY THE COSTS TO SHAREHOLDERS IN REDUCED MANAGEMENT ACCOUNTABILITY

The SEC has long recognized "that a rule's potential benefits and costs should be considered in making a reasoned determination that adopting a rule is in the public interest."[13] However, the Proposed Rule takes a one-sided and narrow approach to its cost-benefit analysis. The PRI finds that the loss of benefits under the Proposed Rule – by reducing the accountability of management to shareholders – dwarf the stated cost savings.

First, the proposal's analysis of the costs of shareholder proposals relies on estimating costs to management of *mere engagement* with shareholders. The costs to management listed are as follows: "(i) review the proposal and address issues raised in the proposal; (ii) engage in discussions with the proponent(s); (iii) print and distribute proxy materials, and tabulate votes on the proposal; (iv) communicate with proxy advisory firms and shareholders (e.g., proxy solicitation costs); (v) if they intend to exclude the proposal, file a notice with the Commission; and (vi) prepare a rebuttal to the submission."[14]

Most of these are costs of persuasion and analysis: they are only costly if the shareholders disagree with the management's position. If the Proposed Rule targets unpopular proposals, the cost savings are likely to be even lower than described. Furthermore, since the Proposed Rule also targets resubmissions – for which the review, discussions, communications, and rebuttals have substantially already been performed previously – then the estimate is likely an overestimate of the costs to companies of the Proposed Rule.

[12] That is, if the number of shares of their largest institutional blockholder voted in favor of the resolution.
[13] Securities & Exchange Commission, Staff of the Rulewriting Divisions and Offices, *Current Guidance on Economic Analysis in SEC Rulemakings*, at 1 (March 16, 2012).
[14] Proposed Rule at 116.

Second, the Proposed Rule does not adequately consider the costs of reduced shareholder monitoring of management due to the rule making it more difficult to sustain shareholder resolutions. Although the Proposed Rule discusses costs to proponents, it lacks any attempt to estimate the benefits of the increased monitoring of management and the value-enhancing potential of certain shareholder proposals, stating: "Our economic analysis does not speak to whether any particular shareholder proposal or type of proposals are value enhancing, whether the proposed amendments would exclude value enhancing proposals, or whether the proposed amendments would have a disproportionate effect on proposals that are more or less value enhancing."[15]

As a wide body of corporate governance literature has noted, shareholders' disciplining of management can be positive for long-term value. A 2012 paper published in the *Journal of Finance*, for example, estimates the passage of *a single* governance proposal causes a positive 2.8% cumulative abnormal return.[16] Similarly, a 2015 paper in *Management Science* finds that implementing a corporate social responsibility shareholder resolution leads to an increase in value by about 1.77%.[17] In contrast, the Proposed Rule estimates $8.9 million per year in cost savings for Russell 3000 companies.[18] Accordingly, these cost-savings are undoubtedly dwarfed by the value-enhancing nature of shareholder resolutions that would henceforth be excluded by the Proposed Rule.

III. OTHER IMPLICATIONS OF THE PROPOSED RULE FOR CORPORATE GOVERNANCE

1. The SEC and Issuers Alike will Lose an Important Measure of Investor Interest that has Historically Led to Landmark Reforms

Corporate transparency is the hallmark of US securities markets — and has been since the creation of the SEC. Indeed, the drafters of the federal securities laws, as well as the modern Supreme Court, have observed that by producing information about how executives are leading companies, corporate disclosure promotes the accountability of those executives to their shareholders.[19] The development

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15 Proposed Rule at 112.

16 *See* Vicente Cuñat, Mireia Gine, & Maria Guadalupe, *The Vote Is Cast: The Effect of Corporate Governance on Shareholder Value*, 67 J. Fin. 1943 (2012) available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1555961.

17 The study finds that "a CSR proposal that passes by a narrow margin of votes yields an abnormal return of 0.92% compared to a CSR proposal that fails marginally." After rescaling the estimated coefficient by the probability of implementing the proposal, the author finds that CSR proposals have a 52% probability of being implemented, which leads to an increase in shareholder value by about 1.77%. *See* Carol Flammer, *Does Corporate Social Responsibility Lead to Superior Financial Performance? A Regression Discontinuity Approach*, Management Science, Vol. 61 No. 11 (2015) available at: https://www.researchgate.net/publication/256034233_Does_Corporate_Social_Responsibility_Lead_to_Superior_Financial_Performance_A_Regression_Discontinuity_Approach.

18 Proposed Rule at 140.

19 *See* Securities & Exchange Commission, *Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance*, Exchange Act Release No. 15,384 (Dec. 6, 1978) ("The legislative history of the federal securities laws reflects a recognition that disclosure, by providing corporate owners with meaningful information about the way in which their corporations are managed, may promote the

of the SEC's disclosure regime, however, has often occurred in response to interest from investors, including through shareholder resolutions. For example:

- In 1978, while considering a proposal to require disclosure related to social issues, the SEC examined investor interest by way of shareholder resolutions in this area. Although it concluded that no rules were required in this area, the SEC noted "that certain social shareholder pro-posals that appear to have social impli-cations have received an average of from 2 to 3% of the vote in recent years and that corporations have apparently not received a significant number of social inquiries from their shareholders."
- In 1992, the SEC enacted rules on disclosure on executive compensation including a requirement to add detailed quantitative information about manager pay. The SEC noted that investors had expressed considerable interest in executive compensation, as the proposed rules cited shareholder resolutions on executive pay at nine companies, with the SEC proposing a rule on disclosure after shareholder vote results of just 5.6%.[20]
- In 2009, the SEC updated its rules to require disclosure on board oversight of risk taking. The SEC observed that the financial crisis had caused "investors [to] increasingly . . . express[] the desire for additional information that would enhance their ability to make informed voting and investment decisions," and issued new rules on disclosure on directors' oversight of risk taking.[21]
- The SEC's 2011 implementation of "Say on Pay" and executive compensation disclosure rules under the Dodd-Frank Act was preceded by several years of shareholder resolutions asking issuers to establish a compensation vote for their executives, prompting other companies to follow suit and helping to convince legislators and regulators to adopt the policy.[22]

The SEC's Proposed Rule would cut off discussion of issues of interest to shareholders, and as a result risks depriving the Commission — as well as companies — of information that has traditionally led to critical new transparency and corporate accountability. Accordingly, the SEC and issuers alike will lose an important source of data on investor interest, which over time will almost certainly result in less disclosure and meaningful reforms in corporate America.

2. Shareholder Resolutions Have Been Critical for ESG Integration and Long-Term Value

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accountability of corporate managers."); *see also Citizens United vs. FEC,* 558 U.S. 310 (2010) (noting "[s]hareholder objections raised through the procedures of corporate democracy").

[20] Securities & Exchange Commission, Executive Compensation Disclosure, Exchange Act Release No. 33-6940 (1992) (executive compensation disclosure resolutions had support of 5.6% of shareholders).

[21] Securities & Exchange Commission, Proxy Disclosure Enhancements, Exch. Act Release No. 33-9089 (2009).

[22] *See* Keith L. Johnson and Daniel Summerfield, *Shareholder Say on Pay - 10 Points of Confusion*, Harvard Law School Forum on Corporate Governance, at 1 (2008) ("[r]esolutions asking companies to adopt Say on Pay have been supported by 42-43% of shareholders over both of the last two proxy seasons") available at: https://corpgov.law.harvard.edu/wp-content/uploads/2008/11/say-on-pay-ten-points.pdf.

As of 2018, over a quarter of the $46.6 trillion in total US assets under professional management are committed to these strategies — and growing.[23] While there are a number of explanations for the rise of ESG investment in the United States, one of the major reasons PRI signatories cite is their ability under the SEC's regulatory framework to hold managers accountable to their shareholders. This has often been done through the shareholder resolution process, which provides a clear, rules-based pathway for investors to bring issues to management and the shareholder base's attention.

In hundreds of cases over the years, investors have come to important agreements with management. Some highlights include:

Environmental

- An analysis of data on climate-related shareholder proposals filed with US companies between 2009-2017 found that 35% of resolutions led to commitments by the company in question.[24]

Social

- A shareholder resolution at Walgreens in 2019 requesting a report on governance measures related to opioids received 61% support.[25] A similar proposal also won majority support at Rite Aid Corporation in 2018.[26]
- Mallinckrodt, a drug manufacturer that has received shareholder proposals in relation to the opioid crisis, recommended shareholders vote for a lobbying disclosure proposal, requesting a detailed report of lobbying activities at the local, state and federal level.[27]

Governance

- In 2005, around 50% of S&P 500 companies had a classified corporate board structure, which declined to less than 20% by 2013, in great part due to shareholder resolutions calling for annual director elections.[28]

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[23] *See* Meg Voorhes, *U.S. Sustainable, Responsible, and Impact Investing Trends*, Investments and Wealth Institute, United States Sustainable Investment Forum (Jan. 2019) at 1 ("The total U.S.-domiciled assets under management using SRI strategies grew from $8.7 trillion at the start of 2016 to $12.0 trillion at the start of 2018, nearly a 40% increase") available at: https://www.ussif.org/files/Article/IWM19JanFeb_US_SRITrends2018.pdf.

[24] Ceres, *The Role of Investors in Supporting Better Corporate Performance*, at 4 (2019), available at: https://www.ceres.org/sites/default/files/reports/2019-04/Investor_Influence_report.pdf.

[25] Bruce Japsen, Forbes.com, *Opioid Suit Loom Over a Walgreens-AmerisourceBergen Deal* (May 21, 2019), available at: https://www.forbes.com/sites/brucejapsen/2019/05/21/opioid-cases-loom-over-a-walgreens-amerisourcebergen-deal/#23b95c1377e6.

[26] *See* RiteAid Corp., Proxy Statement Pursuant to Section 14(a), Stockholder Proposal on Governance Measures Related to Opioids (Sept. 27, 2018) available at: https://www.sec.gov/Archives/edgar/data/84129/000104746918006450/a2236772zdef14a.htm#di40601_proposal_no._6_stockholder_pro__pro03317.

[27] Roll Call, *Opioid Maker Mallinckrodt to support lobbying disclosure* (April 3, 2019) available at: https://www.rollcall.com/news/congress/opioid-maker-mallinckrodt-support-lobbying-disclosure.

[28] Abigail Pickering Bomba, Steven Epstein, Arthur Fleischer Jr., Peter S. Golden, Philip Richter, David N. Shine, John E. Sorkin and Gail Weinstein, Fried Frank Harris Shriver & Jacobson LLP, *A New Approach To Classified Corporate Boards*, at 4 (April 14, 2014) available at: https://www.friedfrank.com/siteFiles/Publications/A%20New%20Approach%20To%20Classified%20Corporate%20Boards1.pdf; Lucian Bebchuk et. al, *Towards the Declassification of S&P 500 Boards*, Harvard Business Law Review, Vol. 3, No. 1, at 157-84 (2013) available at: https://www.hblr.org/wp-content/uploads/sites/18/2013/08/HLB101_crop.pdf.

- Since 2015, investors have asked companies to make the right of investors to nominate directors on the company's proxy ballot a market standard. Just six US companies had proxy access as of 2014, with more than 540 offering it as of 2018, including 60% of the S&P 500.[29] Thirty-five companies, including IBM and Humana, have taken steps to enact proxy access bylaws "with terms substantially similar to those requested by the shareowner proposal." [30]

Significant evidence supports the long-term economic value of ESG integration. A meta-study by Deutsche Asset & Wealth Management and the University of Hamburg, found "62.6% of studies revealed a positive correlation between ESG investing and financial performance," nearly 30% had neutral performance and 8% under performed.[31] A CFA Institute survey found ESG momentum strategy outperformed the MSCI World Index by 16.8% and the MSCI US Index by 18.8%.[32]

Accordingly, by making it more difficult to bring and sustain shareholder resolutions, the Proposed Rule will be damaging for long-term value creation from these critical investment and stewardship strategies.

CONCLUSION

One of the majority Commissioners noted when approving the Proposed Rule that other forms of shareholder engagement have increasingly come to the fore through changes in technology.[33] Indeed, other means of shareholder engagement do exist, but the shareholder resolution process is unique because it requires a *vote*. That is, though precatory, shareholder resolutions promote corporate accountability in a way that other forms of engagement cannot.

[29] New York City Pension Funds Shareowner Initiatives Postseason Report (2017) available at: https://comptroller.nyc.gov/wp-content/uploads/documents/2017_Shareowner_Initiatives_Postseason_Report.pdf; New York City Pension Funds Shareowner Initiatives Postseason Report (2018) available at: https://comptroller.nyc.gov/wp-content/uploads/documents/2018_Shareowner_Initiatives_Postseason_Report.pdf.

[30] New York City Pension Funds Shareowner Initiatives Postseason Report (2018) available at: https://comptroller.nyc.gov/wp-content/uploads/documents/2018_Shareowner_Initiatives_Postseason_Report.pdf.

[31] *See* Deutsche Asset & Wealth Management, the University of Hamburg, and PRI, *ESG & Corporate Financial Performance: Mapping the global landscape* (Dec. 2015) available at: https://institutional.dws.com/content/_media/K15090_Academic_Insights_UK_EMEA_RZ_Online_151201_Final_(2).pdf.

[32] *See* The PRI, *Financial performance of ESG integration* (Feb. 20, 2018) available at: https://www.unpri.org/investor-tools/financial-performance-of-esg-integration-in-us-investing/2738.article (including results from the CFA Institute survey).

[33] *See* Securities & Exchange Commission, *Statement at the Open Meeting: Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8*, Commissioner Elad Roisman (Nov. 5, 2019) ("the internet and social media have allowed shareholders cheap and easily-accessible ways to get messages across to management, directors, and even other shareholders, proving to be incredibly powerful tools for influencing change even in the largest corporations") (*citing* Donna Fuscaldo, Forbes.com, *Say Gives Retail Investors A Voice And Tesla Listens* (Feb. 19, 2019)).

The PRI's letter finds that the basis for the SEC's Proposed Rule is substantially at odds with empirical evidence — and would significantly impede investors' ability to hold management accountable going forward. Accordingly, the PRI recommends that:

- The proposed changes to the resubmission thresholds be removed, particularly the Proposed Rule's momentum requirement.
- Should there be a future rulemaking, the SEC should carefully consider the PRI's analysis in this letter and substantially revise its economic analysis, taking into account, above all, the significant implications of the Proposed Rule for the ability to hold management accountable to their shareholders.

Thank you for the opportunity to share our views. For further conversation and follow up, please feel free to contact our policy team:

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Yours sincerely,

Fiona Reynolds
Chief Executive Officer
Principles for Responsible Investment

cc. The Honorable Jay Clayton, Chairman
The Honorable Robert J. Jackson, Jr., Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner
The Honorable Allison H. Lee, Commissioner

APPENDIX

Data Sources

Proposals are from 2003-2018 from ISS Voting Analytics. We kept only proposals with Sponsor "Shareholder." We removed proposals where meeting type is "Proxy Contest" or where the Agenda General Description includes the phrase "(Opposition Slate)".

Our analysis included all shareholder proposals that were voted on by shareholders, excluding those relating to proxy contests.

Data on institutional investors comes from Thomson Reuters S34.

Methodology

We hand-corrected Agenda General Descriptions, Item Descriptions, and Proponent Names to streamline them, then hand-coded proposals into proposal categories (Environmental, Social, Governance) using framework in Brav, Cain & Zytnick (2019).

We categorized a proposal as a resubmission if it is: (i) at the same firm, (ii) at a subsequent meeting, (iii) with the same Agenda General Description, and (iv) with the same Item Description. Hand-correct Item Descriptions in ambiguous cases. Assign a unique proposal ID to all proposals plus resubmissions.

We calculated percentage of votes in favor as (Votes For) / (Votes For + Votes Against) * 100.

We categorized a proposal as the final appearance on the ballot if it is (i) prior to 2018 and (ii) no subsequent resubmission of the proposal has been made.

For the purposes of determining resolutions that would be "excluded" (or failed to make the ballot) under the Proposed Rule, since a resolution can only be considered to be excluded if it has been voted on in the past three years and our data runs from 2003-2018, we excluded the first three years and look only at 2006-2018 to ensure we can assess whether a proposal has been voted on in the past three years. We started by marking a proposal if it is in its second year and has below 5%, in its third year and has below 15%, or in its fourth year or above and is below 25%. We also marked proposals that are in their fourth year or above and saw a 10% decline in percentage of votes in favor over the two preceding votes (under the "momentum" rule), so long as it has had three votes in the preceding five years. Finally, we unmarked any proposal whose most recent vote was not within three years.

For proposals in 2006 and 2007, we may be slightly under-estimating proposals excluded under the new rule, since we only observe prior submissions from 2003 onward and therefore may be undercounting the number of votes in the preceding five years.

To evaluate the potential impact of institutional investors under the Proposed Rule, for each firm, we use its largest institutional owner (from the 13F nearest to the meeting date and within three years).

Comparability to SEC's Analysis

The SEC's economic analysis is generally focused on submitted proposals, whereas our analysis is focused on proposals actually on corporate ballots. Accordingly, our numbers may not generally be comparable, but they are quite consistent with each other regardless (for example, we have similar ratios of Environmental, Social, and Governance proposals).

We count 882 unique proposal groups resubmitted between 2011 and 2018, very similar to the 864 reported in the SEC proposal on page 52.

Proposals in our sample average 31.9% support from 2004 to 2018, very similar to the 33.4% reported by the SEC on page 84. The SEC reports 42.1%, 21.9%, and 17.4% for G, E, and S proposals, respectively, very similar to our 39.7%, 19.1%, and 17.5%.

Starting on page 101, the SEC reports numbers related to resubmission for proposals from 2011 to 2018. They have 3,620 proposals that went to a vote from 2011 to 2018, fairly similar to our 3,965. The SEC has 60% of proposals as first submissions, 19% as second submissions, and 21% as third or higher, very similar to our 62.6%, 19.0%, and 18.3%, respectively.

On pages 130-132, the SEC reports that it finds an additional 269 proposals (212 from the resubmission threshold, and 57 from the Momentum Requirement) being excludable from 2011 onward, which they report is 19% of the total resubmitted proposals in the time frame. This is fairly similar to what we find, which is 253 excluded proposals from 2011 onward, which is 18.9% of resubmitted proposals in this timeframe.

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

NEIL L. BRADLEY
EXECUTIVE VICE PRESIDENT &
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June 25, 2020

The Honorable Rep. Brad Sherman
Chairman
Subcommittee on Investor Protection,
Entrepreneurship, and Capital Markets
U.S. House of Representatives
Washington, DC 20515

The Honorable Bill Huizenga
Ranking Member
Subcommittee on Investor Protection,
Entrepreneurship, and Capital Markets
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Sherman and Ranking Member Huizenga:

The U.S. Chamber of Commerce appreciates the opportunity to share significant concerns with several bills that you have asked Securities and Exchange Commission ("SEC") Chairman Jay Clayton to address during his testimony for tomorrow's hearing, "Capital Markets and Emergency Lending in the COVID-19 Era." In particular, these bills would treat the private sector in a punitive manner and overlook the important contributions of businesses large and small to help fight the pandemic and to contribute to the economic recovery Americans expect.

H.R. ____, to establish new limits on the Primary Market Corporate Credit Facility

This legislation would subject Primary Market Corporate Credit Facility ("PMCCF") beneficiaries to CARES Act limits on stock buybacks, dividend payments, and executive compensation.

The Chamber opposes this bill to establish new limits on the PMCCF. Under the terms of the PMCCF, authorized by Congress and established by the Federal Reserve Board, the facility may purchase eligible corporate bonds or portions of syndicated loans or bonds of eligible issuers at issuance. Per the terms of the CARES Act, such purchases by the facility are not direct loans, and thus the issuers of such debt should not be subject to limits on stock buybacks, dividend payments, and executive compensation. Such restrictions could cause businesses that are both eligible for the PMCCF and require liquidity to get through these challenging times to opt out of the PMCCF to their detriment. The current crisis is inherently unique in that businesses seeking financing find themselves in such a position through no fault of their own.

A primary intent of the CARES Act was to provide income security. Many retirees and other retail investors that rely on the returns generated by dividends and share repurchases would be harmed by a broad prohibition against such distributions.[1] A dividend is a distribution of a company's profits to shareholders, including pension plan beneficiaries, 401(k) savers, or everyday investors. Many of them, who may be retired or are no longer working, depend on dividends as a reliable, steady stream of income—an increasingly important thing during times of crisis. In these uncertain times, Americans need to be able to access every possible source of income, including dividends from businesses.

Objections to stock buybacks are misguided. Businesses make the most productive decisions they can based on the capital they have. Stock buybacks, like dividends, are a common way to distribute earnings to investors in retirement funds. Shareholders often reinvest gains from buybacks into growing new businesses and creating jobs, which ultimately help the U.S. economy by delivering cash to companies that need capital as a result of the challenges brought on by the pandemic.

H.R. ____, Rulemaking Suspension

This legislation would temporarily prohibit federal financial regulators from adopting rules not directly related to responding to the coronavirus response through the length of the crisis.

The Chamber is concerned that such legislation could hamper the ability of regulators to deal with pressing issues and enact beneficial reforms. This could harm the ability of policy makers to help speed an economic recovery. Determining whether a rule is "directly related" to COVID-19 is entirely subjective and sets a bad precedent for independent regulators. These concerns are also applicable to other independent financial regulators.

H.R. ____, Increase Penalties for COVID-related Securities Law Violations

This legislation would increase civil monetary penalties for COVID-related securities misconduct.

The Chamber is concerned about legislation that would increase civil penalties without any corresponding due process enhancements. Through various important laws, fraud is illegal, and significant tools empower regulators to address fraud or other crimes in the context of the pandemic. New legislation in this area appears unnecessary, and, regardless, this bill lacks traditional due process protections of other statutes.

[1] https://www.uschamber.com/series/above-the-fold/why-keeping-dividends-going-tough-times-the-right-call

H.R. COVID-19 Restitution Assistance Fund for Victims of Securities Violations Act

This legislation would create a fund at the SEC to provide restitution payments for individuals in connection with securities fraud related to coronavirus if they do not otherwise receive full payment of restitution.

The Chamber is highly concerned by the proposal to establish a separate restitution fund for frauds related to the COVID-19 crisis. The SEC already has in place procedures under the federal securities laws by which investors who have been defrauded for any reason may recover some of the financial losses as a result of the fraud. Indeed, the recent Supreme Court ruling strengthens the SEC's ability to provide investors with restitution making this proposal superfluous.

H.R. 6551, the CARES Act Section 4014 Technical Corrections Act

The CARES Act Section 4014 Technical Corrections Act would amend the CARES Act to ensure that the temporary relief from CECL standards does not terminate in the middle of a company's fiscal year.

Section 4014 of the CARES Act provides optional temporary relief from implementing the current expected credit losses (CECL) accounting standard. Section 4014 states no insured depository institution bank holding company, or any affiliate thereof shall be required to comply with CECL during the period beginning on the date of enactment of the CARES Act and ending the earlier of 1) the date on which the national emergency concerning Covid-19 outbreak declared by the President terminates, or 2) December 31, 2020. Section 4014 therefore creates uncertainty for when CECL must be implemented given it is unclear when the President may end the national emergency concerning Covid-19. Moreover, relatively few insured depository institutions availed themselves of the flexibility provided under Section 4014 given they would have to comply with CECL on the day the national emergency ends with relatively short notice. H.R. 6551 would eliminate some uncertainty for a compliance date by amending Section 4014 of the CARES Act by clarifying the effective date would be the fiscal year for the insured depository institution beginning immediately after the national emergency ends.

The Chamber, which supports the independence of FASB and the process for setting accounting standards, believes a long-term solution for addressing concerns that some have raised with CECL regarding the availability of credit should be addressed via a permanent capital offset. In the FY 2020 Omnibus Appropriations Act, Congress mandated Treasury, in consultation with federal banking regulations, complete a study on the need for changes to regulatory capital requirements necessitated by CECL.

H.R. 6375, to require disclosures related to supply chain disruption risk and for other purposes; and H.R. 6371, the Pandemic Disclosure Act

H.R. 6375 would amend the Securities Exchange Act of 1934 to require issuers to make disclosures related to supply chain disruption risk. H.R. 6371 would require that in the event of a World Health Organization declaration of a pandemic, public companies file supplementary disclosures regarding any material impacts that the pandemic is expected to have on its business, including impacts on its workforce.

The Chamber believes that disclosure under the federal securities laws should be tied to the longstanding definition of materiality that focuses on the financial and operating performance of the company. The SEC has encouraged public companies to be transparent about the impact of the COVID-19 crisis on their current financial and operating status and their future operational and financial planning. Public companies are already tasked with disclosing to investors material issues affecting their business, including the recent impacts of the pandemic. The current definition of materiality would capture information that is critical for investors to make informed investment and voting decisions. Broad, one-size-fits-all disclosure mandates are unnecessary and would only create unnecessary costs for issuers and investors.

H.R. 6790, the Business Borrowers Protection Act

The Business Borrowers Protection Act would prevent private creditors from enforcing loan covenants that require an accelerated repayment of existing private loans in the event a business borrower obtains a COVID-19 government relief loan.

The Chamber strongly opposes the abrogation of contracts by Congress and is very concerned that this bill would do so. This bill represents a sweeping intrusion of government into private contracting that would be disruptive to lending and the capital markets. Among the many unintended consequences from changing the borrowing terms on existing contracts, this legislation would add uncertainty to future lending because it would signal a willingness of Congress to intrude and change the terms and conditions of extant lending agreements after the fact. In addition, we are concerned that lenders would bear greater risk of default. It is important to ensure that the interest of lenders is given appropriate consideration so that they do not find themselves accepting undue risk. These issues should be resolved through workouts by lenders and borrowers and the recent TDR guidance by banking regulators is an important tool to accomplish that goal.

H.R.6934, for uniform treatment of NRSROs

This legislation would amend the CARES Act to require the uniform treatment of nationally recognized statistical rating organizations ("NRSROs") under certain programs carried out in response to the COVID-19 emergency.

During a June 2, 2020 hearing of the Senate Committee on Banking, Housing, and Urban Affairs, the U.S. Chamber's Center for Capital Markets Competitiveness raised a concern that the Primary and Secondary Market Corporate Credit Facilities ("PMCCF" and "SMCCF") would lose their effectiveness through its reliance on ratings from the three major NRSROs: Fitch Ratings, Inc., Moody's Investors Service, Inc., and S&P Global Ratings. In the case of the PMCCF and SMCCF, which may be a critical source of support to larger enterprises that are ineligible for other programs, we encouraged the Federal Reserve at that time to consider including all SEC-registered NRSROs.[2]

Ratings for eligible issuers will also be accepted from NRSROs DBRS, Inc., Kroll Bond Rating Agency, Inc., and A.M. Best Rating Services, Inc. (the last of which only with respect to insurance companies), *provided* that the issuer seeking support from the PMCCF and SMCCF also has a rating from the major three NRSROs. Such policies would continue to exclude those issuers who require liquidity in these challenging times who do not also have qualifying rating from the major three major NRSROs.

H.R. 7000, the Holding Foreign Companies Accountable Act

The Holding Foreign Companies Accountable Act would suspend trading in the stock of a foreign company listed on a U.S. exchange if the independent auditor of that company is not subject to full PCAOB oversight for three consecutive years.

Transparency and disclosure are fundamental pillars of the American economy. Any company, domestic or foreign, that cannot abide by U.S. securities laws or regulations or exchange listing standards should not be listed on American stock exchanges. The SEC has been able to negotiate reciprocal inspection agreements with other nations to deal with cross border issues, despite cultural or economic differences. The U.S. and China need to reach such an agreement. In 2013 testimony before the U.S.-China Economic Security Review Commission[3], the Chamber discussed the challenges and risks associated with a failure to audit Chinese companies.

We are concerned that the legislation, as written, could have unintended consequences for multinational companies headquartered in the U.S. with subsidiaries and affiliates located in a foreign jurisdiction that are not complying with U.S. securities laws or exchange listing standards. We encourage the Subcommittee to evaluate the extent to which U.S. subsidiaries and affiliates that operate in China could be impacted through this legislation, and to modify the bill to mitigate such unintended consequences.

[2] https://www.banking.senate.gov/imo/media/doc/Quaadman%20Testimony%206-2-203.pdf
[3] https://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/US-China-Economic-Security-Review-Commission1.pdf

SEC Response to COVID-19

Finally, the U.S. Chamber of Commerce would like to acknowledge the timely and impactful actions taken by the SEC in response to the COVID-19 crisis. The SEC has responded quickly to the COVID-19 crisis by engaging in operational initiatives, market-focused actions, guidance and targeted assistance and relief, and investor protection efforts. In particular, we commend the SEC for encouraging public companies to disclose to investors the impact of the COVID-19 crisis on their current financial and operating status and their future operational and financial planning when they issue earnings releases and conduct analyst and investor calls.[4] Given the challenge of providing forward-looking disclosures, we agree with the SEC's encouragement to companies to avail themselves of safe-harbors for such statements.

Sincerely,

Neil L. Bradley

cc: Members of the Committee on Financial Services

[4] https://www.sec.gov/news/public-statement/statement-clayton-hinman

Congressman Brad Sherman
Questions for the Record
House Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets Hearing: "Capital Markets and Emergency Lending in the COVID-19 Era"
Thursday, June 25, 2020

Chairman Clayton, I am very pleased to have your support for the Holding Foreign Companies Accountable Act, which Senators Kennedy and Van Hollen and Congressman Gonzalez and I have put forward. While the Commission has recommended technical revisions to the bill to ensure that companies which do a majority of their business in the U.S. and other jurisdictions that the PCAOB does have access to are not subject to trading suspensions, you have also indicated that the current bill language leaves SEC with enough flexibility to avoid this issue, correct?

Answer:

I believe the approach taken in the Holding Public Companies Accountable Act is a very sensible way to address a persistent problem with serious consequences for our capital markets. I believe the SEC could implement the legislation in a manner that ensures it would not apply to companies with operations predominately in the U.S. and foreign jurisdictions where the Public Company Accounting Oversight Board (PCAOB) is able to inspect registered audit firms. That said, as generally is the case, providing more clarity and direction regarding the scope of the legislation would help ensure the Commission implements the legislative mandate in a manner consistent with congressional intent.

Regarding the importance of this issue more generally, 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 a materially unlevel playing field with respect to PCAOB inspections for issuers from certain emerging markets is unacceptable.

In order to bring greater attention to these risks, SEC staff and I, along with the Chairman of the 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. 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. To further promote engagement and help inform our consideration of these issues, in July, the SEC held a roundtable where investors, other market participants, regulators and industry experts discussed issues related to the risks of investing in emerging markets, including China. In connection with the Roundtable, the SEC also opened a public comment page to provide members of the public an opportunity to submit their views as well as review the views of others.[1]

On August 6, 2020, the President's Working Group on Financial Markets released its Report on Protecting United States Investors from Significant Risks from Chinese Companies (PWG Report).[2] The PWG Report includes five recommendations for the Securities and Exchange Commission that are centered on strengthening protections for investors and promoting the integrity of our capital markets by: (1) leveling the playing field for all companies listed on U.S exchanges and (2) improving disclosure regarding, and consideration by fiduciaries and other market professionals of, the risks of investing in emerging markets, including China. I have directed the SEC staff to prepare proposals in response to the report's recommendations for consideration by the Commission and to provide assistance and guidance to investors and other market participants as may be necessary or appropriate.

I look forward to continuing to work with Congress on this issue to help ensure transparency and confidence in our markets.

Question:

Chairman Clayton, as you are aware, many institutional investors, including public pension funds, rely on proxy advisor firms to help manage the annual proxy process, which can be a significant burden. According to the California Public Employees' Retirement System, the fund was asked to vote on well over 3,000 proxies for the 2019-2020 proxy season alone. I am very concerned that the Commission's proposed rule may increase the costs of or significantly limit the availability of proxy advisor services. For public pension plans this would mean diverting resources away from providing retirement income to pension plan participants. Has the SEC performed any form of economic analysis to study how its proposed rule may increase costs for investors who rely on proxy advisor firms?

Answer:

Modernizing and enhancing the effectiveness, efficacy and efficiency of the proxy process for the benefit of all shareholders is an important priority of the Commission. The proxy system is the primary means through which most public company shareholders cast their votes and express their views to companies and other shareholders on matters of collective importance. Proxy voting advice businesses have come to play a significant role in the proxy voting process. They provide 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

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[1] *See* Spotlight on Risks for Investors in Emerging Markets, *available at* https://www.sec.gov/page/emerging-markets-roundtable.

[2] President's Working Group on Financial Markets, Report on Protecting United States Investors from Significant Risks from Chinese Companies (July 24, 2020), *available at* https://home.treasury.gov/system/files/136/PWG-Report-on-Protecting-United-States-Investors-from-Significant-Risks-from-Chinese-Companies.pdf.

over a sizeable number of shares that are voted annually, proxy voting advice businesses are uniquely situated to influence investors' voting decisions and, as a result, the proxy voting process more generally.

On July 22, 2020, the SEC adopted amendments to its rules governing proxy solicitations designed to ensure that clients of proxy voting advice businesses have reasonable and timely access to more transparent, accurate and complete information on which to make voting decisions. The amendments aim to facilitate the ability of those who use proxy voting advice—investors, fund managers and others who vote on investors' behalf—to make informed voting decisions without imposing undue costs or delays that could adversely affect the timely provision of proxy voting advice and the operation of the proxy process more generally. The principle that more complete and robust information and discussion leads to more informed investor decision-making, and therefore results in choices more closely aligned with investors' interests, was a principal factor in the Commission's adoption of these amendments.

Robust economic analysis often is an important part of the Commission rulemaking process. The recent Commission effort to modernize the rules governing proxy voting advice has been guided by careful consideration of the potential benefits and costs of any new rules on investors and other affected parties. In adopting these new rules, the Commission considered the comprehensive analysis of the economic effects of the new rules conducted by staff in the Division of Economic and Risk Analysis. The analysis, which is included in the Commission's adopting release, reflects the public comments on the Commission's original rule proposal and describes in detail the anticipated costs and benefits of the final rules on investors, registrants and other affected parties.[3]

As explained in the economic analysis, the changes resulting from the final rules are expected to be beneficial for clients of proxy voting advice businesses, such as investment advisers and institutional investors, and will likely improve the overall proxy voting process, including by providing greater transparency and a more robust mix of information. For example, the new conflict of interest disclosures are expected to benefit the clients of proxy voting advice businesses by enabling them to better assess the objectivity of the proxy voting advice. Similarly, the new requirements for proxy voting advice businesses to establish policies and procedures reasonably designed to allow their clients to be aware of registrants' views are expected to benefit these clients—and thereby ultimately benefit the investors they serve—by enhancing the overall mix of information available to those clients as they assess proxy voting advice and make determinations about how to cast votes.

The Commission also carefully considered the costs of the final rules described in the economic analysis. The economic analysis acknowledges that the new rules will likely generate direct and indirect costs for proxy voting advice businesses and potentially their clients. Among other things, the final rules may impose indirect costs on the clients of the proxy voting advice businesses if the businesses pass along additional compliance costs to their clients. The analysis also addresses other potential costs and concerns raised by commenters, such as possible

[3] *See Exemptions from the Proxy Rules for Proxy Voting Advice*, Release No. 34-89372 (July 22, 2020), *available at* https://www.sec.gov/rules/final/2020/34-89372.pdf.

impairment of the independence of the proxy voting advice and potential delays in delivering the voting advice to clients. Further, investment advisers and other proxy voting advice business clients may incur additional costs in connection with the review of additional soliciting materials filed by registrants in response to the voting advice.

The economic analysis notes, however, that final rules reflect significant changes from the Commission's initial proposal due to commenters' input, resulting in final rules that are less costly as compared to the costs of the proposed rules. For example, the more flexible, principles-based approach adopted by the Commission should reduce compliance costs and allow proxy voting advice businesses to design policies and procedures that best suit their clients' needs. Ultimately, the economic analysis concludes that, when compared to the current economic baseline, the final rules are expected to generate benefits for clients of proxy voting advice businesses, with the largest benefits coming from the enhanced disclosures and policies and procedures required by the new rules.

Question:

Chairman Clayton, recent reports show that up to 100,000 small businesses have closed their doors forever because of the Covid-19 economic recession. Many more remain at risk. As we work towards an economic recovery, for many small businesses access to capital will likely play an important role in determining whether they are able to continue operating and return to growth. However, any policy proposal which seeks to expand access to capital must not come at the cost of eroding investor protections nor accelerating the decline in the number of publicly traded companies. Proponents of venture exchanges contend that allowing for the creation of these exchanges would increase the availability of capital for small businesses while not creating significant new risks for investors nor disincentivizing companies from going public. Specifically, the creation of venture exchanges, as proposed by the Main Street Growth Act, would provide a new trading venue for small issuers to be able to list and sell shares. With respect to this proposal, it would be valuable to understand any conclusions you may have reached regarding how this might impact markets and investors. Specifically, it would be helpful to know, is there any expectation that the creation of venture exchanges would increase efficiency in the trading of shares which would be eligible for listing? Would you expect the creation of venture exchanges to allow for greater regulatory oversight of these markets?

Answer:

We have received input from market participants over the years on the need to consider ways to improve secondary market liquidity in the securities of smaller companies, including with respect to the creation of venture exchanges. In the Concept Release on Harmonization of Securities Offering Exemptions, which the Commission issued on June 18, 2019, we requested comments from the public on what steps we should consider to improve secondary trading liquidity of securities exempt from registration, including whether we should consider permitting securities that were exempt from registration to trade on venture exchanges. Additionally, we sought feedback on how allowing such securities to trade on venture exchanges prior to being fully seasoned would affect the companies issuing such securities. Commenters' views on these points were mixed, with some support for the view that the creation of venture exchanges would increase efficiency in the trading of eligible shares. We are carefully considering the comments received in connection with our broader effort to simplify, harmonize, and improve the exempt offering framework under the Securities Act of 1933 to promote capital formation and expand investment opportunities while maintaining and enhancing appropriate investor protections.

In the past, Commission staff have worked with exchanges as they considered establishing venture exchanges and are willing to continue that dialogue with interested market participants. As with other types of national securities exchanges, venture exchanges are required to register with the Commission. Their rules and other material aspects of their operations are subject to a public notice and comment process, and, ultimately, Commission approval. To approve an exchange rule proposal, the Commission must find that it is consistent with the relevant provisions of the Securities Exchange Act of 1934.

Given the large number of securities that are thinly traded, we have been working on how to improve the market structure for those thinly traded securities that are already listed on U.S. exchanges. To that end, the Commission issued a Statement on Market Structure Innovation for Thinly Traded Securities in October 2019 that invites proposals to address the market for thinly traded securities. It identifies several potential market structure changes as a few examples of types of innovations that exchanges and other market participants could consider developing that might facilitate improved trading in thinly traded securities, although the list is not intended to be exhaustive or to limit the possibilities market participants could consider. We encourage exchanges and other market participants, including issuers, to explore various types of market structure innovations to address the liquidity challenges in trading these securities.

Question:

Chairman Clayton, I continue to have serious concerns with the CECL accounting standard. As I have indicated previously, a more recent issue that I have focused on has been the inconsistent application of the standard across depository financial institutions versus non-depository financial firms. As you are aware, Section 4014 of the CARES Act provided certain depository institutions with the temporary option of continuing to rely on the "incurred loss" model rather than the CECL standard. To date, non-depository firms have not received any similar flexibility. Similar to banks, many of the publicly traded non-bank financial companies offer a wide range of services, including small business lending, consumer and personal loans, credit cards, mortgage, automotive and commercial lending services. It would seem this inconsistent application of the CECL standard has created a bifurcated playing field which may result in these firms curbing their lending activity and create challenges for investors. Would it make sense to adjust accounting standards appropriately to make that more consistent?

Answer:

I appreciate the swift and decisive actions by Congress and our regulatory colleagues in response to COVID-19 to stop the spread and provide emergency assistance and support to individuals and businesses affected by the pandemic and resulting economic conditions. The

Commission and its staff have similarly acted to facilitate market function and preserve market integrity, as well as to provide guidance and relief, where appropriate, to market participants affected by COVID-19. In executing these responsive measures, my colleagues and I have been guided by our commitment to market integrity and the interests of our long-term Main Street investors.

The language in Section 4014 of the CARES Act has raised questions for companies attempting to apply that optional relief in their financial reporting to investors. In response to specific questions in this area, SEC staff has interacted extensively with financial institutions, auditors, other financial regulatory agencies and various other external stakeholders. SEC staff has sought to provide reasonable and practical guidance to address the questions arising following the enactment of the legislation in accordance with the statutory language. For example, SEC staff issued a statement to clarify that any election under Section 4014 of the CARES Act is in accordance with GAAP.

Additionally, in order to assist registrants that need to plan for a transition out of the deferral and to CECL during 2020, SEC staff has indicated that registrants should plan to transition to CECL based on the termination provisions set forth in the CARES Act and has indicated an acceptable approach would be for a registrant to adopt CECL in its filing for the reporting period that includes the expiration date. For example, assuming a termination date of August 5, 2020, SEC staff noted that a company would apply CECL as of the end of the third quarter (September 30, 2020). Consistent with existing accounting principles, for the nine months ending on September 30, 2020, the company would apply the effects retrospectively to January 1, 2020, in the third quarter filing. In addition to being consistent with existing GAAP, this method has the benefit of ensuring comparability and consistency across all banks when the optional deferral period ends, and importantly, the company would not be required to restate prior quarterly reports.

I understand Congress's interest in providing optional temporary relief from CECL during these unprecedented times both to relieve the compliance burden on financial institutions and to mitigate any potential adverse impacts on capital. Additionally, I appreciate your interest in applying this relief in a manner that is both uniform with respect to accounting standards and in application across all financial institutions and their parent companies. Given that the CARES Act provision is drafted narrowly and explicitly applies to a limited number of registrants for a specific timeline, I would be reluctant to expand the optional relief to additional entities or for a period of time that extends beyond the parameters set by the CARES Act. If requested, SEC staff can provide technical assistance and work with Congress in drafting future legislation to achieve this goal.

As a general matter, many concerns regarding CECL focus on its impact on bank regulatory capital, which is subject to oversight by the federal banking agencies. The federal banking agencies recently provided relief regarding the regulatory capital treatment stemming from implementation of CECL, which I believe addresses many of the concerns expressed related to the regulatory capital implications of CECL and procyclicality. Additionally, most large and regional banks have implemented CECL for 2020, and as I understand, would not be interested in switching back to the incurred model given the costs of implementing the new standard coupled with the relief from the banking regulators.

I do believe, however, we should evaluate how CECL is performing during these times of unprecedented stress and assess whether additional guidance or other actions are necessary. The SEC will continue working with the Financial Accounting Standards Board (FASB) to evaluate CECL, while respecting their independence.

Question for the Record from Congressman Jim Himes for the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets Hybrid Hearing Entitled "Capital Markets and Emergency Lending in the COVID-19 Era"
Thursday, June 25, 2020 12:00 PM

The Honorable Jay Clayton, Chairman, U.S. Securities and Exchange Commission:

Chairman Clayton, following the market response to the COVID-19 crisis, several central banks have released reports that contain preliminary assessments of potential financial stability risks. As a member of the Financial Stability Oversight Council and as Chairman of the primary regulator of capital markets, what do you see as the SEC's role in identifying any financial stability risks in capital markets and responding to those identified risks? As a primary regulator, the SEC already collects a substantial amount of data from market participants; how will the SEC work with FSOC to ensure that the Council has appropriate access to that data so that financial stability assessments are data driven?

Answer:

During periods of stress, the SEC's key focus is on maintaining fair and orderly market function. To achieve this, the SEC staff focuses on three primary areas:

- ***Market function***. Using our expertise and experience to help ensure the continuing, orderly and fair function of the securities markets—including equities, fixed income securities, funds and other products.
- ***Market monitoring***. Monitoring market prices and price movements, flows of capital and availability of credit to assess functionality and resiliency of the capital markets—and taking action, including providing regulatory relief and guidance, as appropriate.
- ***Corporate and other issuer disclosure***. Monitoring and providing guidance concerning, and emphasizing, timely and accurate issuer and other disclosures, recognizing that transparency and broad disclosure of material information are fundamental to market function and resiliency.

In response to recent events, SEC staff has undertaken a number of initiatives to ensure fair and orderly market function. In April, building on the Commission's ongoing market monitoring and response work, the SEC formed an internal, interdisciplinary COVID-19 Market Monitoring Group to 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 policymakers. In addition to the broad market-oriented work, we have also initiated work to: (1) identify, analyze and clarify interconnections across key segments of our financial markets with increased specificity; and (2) analyze the risks and potential procyclical effects of investment strategies and mandates that include or are subject to mechanistic rules, guidelines or restrictions on holdings of assets—for instance, by reference to ratings and downgrades. This work supports and complements similar efforts being undertaken by our domestic and international regulatory partners.

Recently, SEC staff published a report, *U.S. Credit Markets: Interconnectedness and the Effects of the COVID-19 Economic Shock*, examining the structure and function of the $54 trillion U.S. credit markets.[4] In the U.S. credit markets, banking and non-banking entities and intermediaries are intricately and inextricably interconnected, which is essential for the functioning of the markets, the provision of credit and the distribution of risk. These interconnections can both facilitate risk absorption and accelerate risk transmission and amplify risks in times of stress. The primary purpose of the report is to identify key structural and flow-related interdependencies in the U.S. credit markets, as well as areas of stress caused by the COVID-19 shock, with an eye toward information policymakers as we seek to improve the functioning and resilience of our financial markets. Some of the key takeaways from the report include:

- The U.S. credit markets—in size, structure and function—have changed significantly since the 2008 financial crisis;

- The broad stress in the short-term funding markets caused by the COVID-19 shock demonstrated that the ability and willingness of intermediaries (e.g., "market makers") to absorb significant, rapid shifts in investor sentiment (e.g., a "dash for cash") is limited in absolute terms and may become more limited as spreads widen and volatility increases during periods of stress and uncertainty;

- Due to the interconnected nature of our credit markets and the size and scope of the COVID-19 shock, it was insightful, prudent and, perhaps, essential that the actions of the Federal Reserve and the CARES Act were multi-faceted and immediate. Those actions were instrumental in ameliorating stress in the credit markets, particularly the short-term funding markets;

- The combination of the Federal Reserve's intervention and the CARES Act also was extremely important in stabilizing prices (e.g., housing prices) and sustaining economic activity (e.g., consumer spending), which in turn added stability to the credit markets;

- General economic and credit stresses from the initial and ongoing effects of the COVID-19 shock are still unfolding, and we must continue monitoring key market segments, including corporate debt, municipal securities and commercial real estate—both individually and as interconnected components of our financial system.

On October 14, 2020, the SEC held a roundtable to discuss the report, which brought together an impressive group of market participants and domestic and international regulators.[5] I expect our initial efforts in this area will facilitate further engagement on systemic risk and financial sector vulnerabilities.

[4] SEC Staff Releases Report on U.S. Credit Market Interconnectedness and the Effects of the COVID-19 Economic Shock (Oct. 5, 2020), *available at* https://www.sec.gov/news/press-release/2020-245-0.
[5] *See* Roundtable on Interconnectedness and Risk in U.S. Credit Markets (Oct. 14, 2020), *available at* https://www.sec.gov/news/upcoming-events/roundtable-interconnectedness-and-risk.

Complementing the interconnectedness initiative is the staff's work on procyclicality. Staff has been exploring whether credit assessments and credit rating agency downgrades—and market anticipation of, and responses to, those ratings actions—may (1) contribute to negative procyclicality in certain circumstances and (2) have implications for financial stability. Together these projects are informing the Commission's assessment of the risks facing the markets.

Our work on these and other initiatives would not be possible without close and active coordination with other financial regulators and public sector officials—both domestic and foreign. The staff has, and will continue, to engage in staff-to-staff communication, coordination and information sharing with our fellow regulators and other authorities concerning risks to investors, companies, state and local governments and other issuers, and the financial system as a whole. This includes engagement with various personnel from the Treasury Department, National Economic Council (NEC), Federal Reserve Board, Federal Reserve Bank of New York, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Commodity Futures Trading Commission (CFTC) and Federal Housing Finance Agency (FHFA), among others. These efforts have occurred on both a bilateral and multilateral basis, including through participation in bodies such as the Financial Stability Oversight Council (FSOC) and the President's Working Group on Financial Markets (PWG), as well as ad hoc multi-agency efforts.

Congressman Emanuel Cleaver Questions for the Record for SEC Chairman Clayton

Penalties and Fees

When the SEC determines there is a widespread industry practice that could be in violation of, for example, the Investment Adviser Act, how does the SEC decide whether to engage in an enforcement action, the issuance of guidance, or a rulemaking?

Answer:

The Commission makes decisions to bring enforcement actions, engage in rulemaking or to issue Commission guidance on a situational basis.

Since it was launched in 2018, the SEC's Share Class Selection Disclosure Initiative has collected over $193 million for at least 96 firms; the Initiative relied on previous settlements and retroactively applied published guidance as the basis to extract those settlements from firms. The SEC has expanded this practice into enforcement against bank sweeps and retail wrap fee programs.

- **Why has the SEC chosen to expand these practices into bank sweeps and retail wrap fee programs?**
- **In these cases, did the SEC seek to provide notice and opportunity to remedy these violations directly with consumers prior to the imposition of retroactive guidance? Why or why not?**
- **Does the SEC plan to promulgate regulations to provide greater clarity to market participants rather than issue retroactive guidance? Why or why not?**

Answer:

The Share Class Selection Disclosure Initiative (the Initiative) concerned advisers that directly or indirectly received 12b-1 fees in connection with recommending, purchasing, or holding 12b-1 fee paying share classes for its advisory clients without adequate disclosure, including disclosures that were inconsistent with the advisers' actual practices. This voluntary initiative provided eligible advisers with the opportunity to address issues with disclosures, make distributions to clients harmed by the firm's undisclosed conflicts, and to do so quickly, with less cost than a typical investigation and without a civil monetary penalty. After reviewing a self-reporting adviser's submission, the staff asked follow-up questions and determined whether it believed that the facts and circumstances merited recommending an enforcement action and, if so, the appropriate scope of any such recommendation. The Commission then considered the recommendations and determined whether to initiate proceedings against each firm.

The Commission's orders found that the investment advisers failed to adequately disclose conflicts of interest related to the sale of higher-cost mutual fund share classes when a lower-cost share class was available. Specifically, the Commission's orders found that the settling investment advisers placed their clients in mutual fund share classes that charged 12b-1 fees—which are recurring fees deducted from the fund's assets—when lower-cost share classes of the same fund were available to their clients without adequately disclosing that the higher cost share class would be selected. The 12b-1 fees were routinely paid to the investment advisers in their capacity as brokers, to their broker-dealer affiliates, or to their personnel who were also registered representatives, creating a conflict of interest with their clients, as the investment advisers stood to benefit from the clients' paying higher fees. Most of the advisory clients harmed by the disclosure practices were retail investors, and the Initiative helped to put money back into their hands and called for the advisers to take remedial steps.

The Initiative and related cases were based on well-established principles under the securities laws, which the Commission applied to the specific circumstances of each firm that chose voluntarily to participate in the Initiative. The basis for the Initiative and related cases was not, and is not, retroactively applied guidance. Adopted by Congress in 1940, the Advisers Act establishes a federal fiduciary standard for investment advisers. For decades, it has been recognized that the fiduciary obligations of investment advisers include an obligation to eliminate or at least make full and fair disclosure to clients and prospective clients concerning their conflicts of interest, including conflicts arising from financial incentives, and to act in their clients' best interest. These fiduciary principles were confirmed by the Supreme Court more than 50 years ago in *Capital Gains*[6] and are enforceable through the antifraud provisions of the Advisers Act.[7] Full and fair disclosures about conflicts and other material facts are necessary because they enable clients and potential clients, including retail investors, to make informed choices when deciding whether to hire or continue retaining an investment adviser.

In addition, Form ADV, which all registered advisers must file and which has been adopted and amended in Commission rulemakings after notice and comment, requires disclosure of conflicts that an adviser has or is reasonably likely to have. Form ADV specifically requires disclosure concerning the compensation and fees that advisers and their supervised persons receive, including from asset-based charges and other fees received in connection with client investments. In addition, Form ADV reminds advisers that, to satisfy their disclosure obligations as fiduciaries, they may need to disclose to their clients information about conflicts that is not specifically required by the Form.

The conduct that resulted in the mutual fund share class selection cases, including the cases brought through the Initiative, involved violations of these long-standing disclosure requirements and principles. Firms know or should know what compensation they receive and whether the circumstances under which they receive it create incentives that give rise to actual or potential conflicts of interest. The compensation at issue in these cases, 12b-1 fees and revenue sharing, gave rise to conflicts related to, for example, the types of investments, the fund families, the particular funds and the share classes of individual funds that the advisers recommended. For instance, when an adviser receives, directly or indirectly, 12b-1 fees in connection with mutual fund recommendations, it has a financial incentive to recommend that a client invest in a share class that pays 12b-1 fees. The resulting conflict of interest is especially pronounced when share classes of the same funds that do not bear these fees are available to the client.

[6] *SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963).

[7] The Commission also discussed the application of this principle in the context of share class selection at least as early as 2006 in the matter of *IFG Network Securities*, stating that where the only bases for the difference in rate of return between mutual fund share classes are the cost structures of those share classes, information about the cost structure would be important to a reasonable investor.

There are more than 13,000 registered investment advisers, which offer a wide range of services and products through a variety of business models. Moreover, market practices evolve regularly, including with respect to compensation arrangements and fund sales practices more generally. The Advisers Act is, by design, a principles-based regime, which has helped enable it to provide robust investor protection while establishing a flexible framework that accommodates this variety and development. The Initiative and the cases that preceded the Initiative reflect a key fiduciary and investor protection principle that is well-established and well-understood by investment advisers—an adviser must provide full and fair disclosure of its conflicts of interest and other material facts and act in accord with its disclosures. Indeed, many investment advisers appear to have recognized the kinds of conflicts addressed in the Initiative and had previously responded through practices designed to address them, including through elimination, disclosure or a combination of disclosure and mitigation.

Because the fiduciary principles discussed above apply to all conflicts, not just those related to 12b-1 fees and revenue sharing, the Commission staff continues to inquire into circumstances where investment advisers have conflicts that have not been fully and fairly disclosed or where conflicted advice may result in recommendations that are not in their clients' best interests. The staff is looking, for instance, at whether advisers have such conflicts where they recommend cash sweep options or higher cost share classes to avoid paying transaction costs that the advisers would be required to pay under their agreements with their clients. As with the cases in the Initiative, failure to address these conflicts appropriately can cause financial harm to investors, particularly retail investors, including being deprived of the ability to make informed investment decisions when purchasing share classes, when determining what cash sweep option, if any, to use, and when determining the appropriateness of an advisory fee.

The Commission will continue to look for opportunities to provide its views to market participants regarding their responsibilities, where needed and in an appropriate form. In a recent example, last year, the Commission published an interpretive release about the fiduciary duties of investment advisers to reaffirm, and in some instances clarify, certain aspects of the fiduciary duty that an investment adviser owes to its clients under the Advisers Act.

During a Senate Banking Committee hearing in December 2019, you described the Share Class Selection Disclosure Initiative as necessary because the Commission observed "widespread conduct that was clearly problematic."

However, I understand that mutual funds have historically used 12b-1 fees to compensate financial advisors and no statute or rule changed the manner in which those fees were disclosed.

- **Why didn't the Commission engage in rulemaking on the use of 12b-1 fees?**
- **Does the SEC plan to initiate a comprehensive rule related to fees and disclosure that could provide both greater clarity to participants and protections for consumers?**

Answer:

The Initiative was not the result of a change in law and did not reflect a value judgment concerning any particular financial incentive, scope of services or fee structure. Market practices evolve regularly, including with respect to compensation arrangements and fund sales practices more generally, and an adviser's fiduciary obligations continue to apply even as its business and the markets about which it offers advice change over time. The Initiative was motivated by evidence that, as the types of share classes to which retail investors had access and adviser compensation practices evolved, a number of advisers were not providing full and fair disclosure concerning the resulting conflicts of interest from charging 12b-1 fees where lower fee classes were available. At the same time, many investment advisers appear to have recognized the kinds of conflicts addressed in the Initiative and had responded, prior to the Initiative, through practices designed to address them, including through elimination, disclosure or a combination of disclosure and mitigation.

The Commission will continue to look for opportunities to provide its views to market participants regarding their responsibilities where needed and in an appropriate form. In a recent example, last year, the Commission published an interpretive release about the fiduciary duties of investment advisers to reaffirm, and in some instances clarify, certain aspects of the fiduciary duty that an investment adviser owes to its clients under the Advisers Act. In addition, the Commission adopted Form CRS last year, which requires an investment adviser or broker-dealer to provide succinct information about the relationships and services that it offers to retail investors, fees and costs that retail investors will pay, specified conflicts of interest and standards of conduct, and disciplinary history, among other things.

Facebook

I sent a letter to Facebook this month, along with a number of other members of Congress, concerning Facebook's failure to adhere to its own internal policies.

- **Has the SEC explored Facebook's responsibility to shareholders in policy adherence and disclosure?**
  - **If you have, what is the nature and of the SEC's review?**
  - **If no, why not?**
- **What is your perspective on Facebook's failure to adhere to its own policies, as expressed in recent reporting and possible risk posed to investors?**
  - **Would you consider this responsible management practices consistent with the responsibility to shareholders?**

Answer:

While I cannot comment on a particular company or its disclosures in filings with the Commission, the Division of Corporation Finance selectively reviews filings made under the Securities Act and the Exchange Act to monitor and enhance compliance with applicable disclosure requirements. In its filing reviews, the Division concentrates on material disclosures that appear to conflict with Commission rules and on disclosures that appears to be materially deficient. The staff may provide a company with comments asking it to revise its disclosure or provide additional disclosure where the staff believes a company can significantly enhance its compliance with the applicable requirements. To the extent that a company's failure to adhere to its own policies has a material impact on its operations resulting in material information that should be disclosed in the company's filings and the information is not disclosed, the staff may issue comments asking the company to provide such disclosure.

You have been outspoken in the past of Facebook's Libra Initiative, and your thinking as a regulator as well as a member of the Financial Stability Oversight Council would be welcomed.

- **What is the status of both SEC's and FSCO's review of the appropriate oversight of Facebook's initiative? (I would welcome a complete update on all actions on this point)**

Answer:

SEC staff is looking closely at the Libra project and 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.

Generally, we look at whether the digital asset fits the definition of a security as set forth in the federal securities laws. Simply calling a digital asset a "payment tool" 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. The federal securities laws define "security" broadly to encompass virtually any instrument that may be sold as an investment. One relevant analysis involves the application of longstanding case law holding that an investment with the expectation of profits through the efforts of another is a security.

As distributed ledger technology involves the issuance and transfer of digital assets—which could be securities, commodities derivatives or something else—there is potential for regulatory overlap. The Commission works closely with other regulators, including the CFTC, FinCEN and the FSOC working group, to coordinate our activities to the extent possible and appropriate under the circumstances.

U.S. Attorney for the Southern District of New York

Following Attorney General Barr's announcement of the president's intent to appoint you as U.S. Attorney for the Southern District of New York, there was clearly a significant amount of confusion.

Question:

Do you intend to serve the remainder of your term as Charmin of the SEC or vacate this position? (yes or no)

Did you intend to vacate the position of SEC Chairman, consistent with the announced statement of Attorney General Barr? (yes or no)

- **If yes, why did you desire vacate the chairmanship?**

Since I was confirmed in May 2017 to lead the Commission, I have been fully committed to serving as Chairman of the SEC. I have devoted my full attention to my duties throughout my tenure as Chairman and continue to do so. This is my first term in public service since the early 1990s, and working with the incredible women and men of the SEC over the past three and a half years has strengthened my desire to continue in public service. The SEC's dedicated professionals are committed to righting wrongs, preventing harm and bringing bad actors to justice. I have had the privilege of overseeing the 1,300 dedicated attorneys in our Enforcement Division, and under my tenure as Chairman, the Commission has brought over 2,750 enforcement actions, obtained over $14 billion in financial remedies, distributed more than $3.5 billion to harmed investors and paid awards of approximately $565 million to whistleblowers. I could not be more proud of the work of my colleagues over the past several years on behalf of Main Street investors and our markets. This is one of the factors that drove my decision to consider the U.S. Attorney position for the Southern District of New York.

I also have a long-held, deep respect for the work of the Southern District, which is recognized throughout our nation and internationally for enforcing the law and pursuing justice without fear or favor. My deep personal respect is largely a result of many years working with the Southern District and its many distinguished alumni, including senior personnel at the SEC. I consulted with several of these alumni as I considered the possibility of the U.S. Attorney position.

Another key driver of my decision to consider the U.S. Attorney position is family. My family has been based in New York during the entirety of my tenure as Chairman. Traveling to Washington, DC, weekly and spending significant time away from my family led me to make a commitment to them that I would not spend longer than one presidential term away from my family and our home in New York. In an effort to facilitate as orderly a transition as possible, I began making it clear several months ago that absent an unexpected development in our markets, I would be returning to my family in New York sometime around or after the 2020 election.

Question

Did the president, or a White House official, vet and offer you the position of U.S. Attorney for the Southern District of New York?

- **If yes, please describe the precise circumstances and process surrounding your announced offer and appointment to the position.**

What, if any, communication have you had with Attorney General Barr on leaving the SEC and serving as U.S. Attorney for the Southern District of New York?

- **When exactly did any such communication occur?**

Answer:

Consistent with the commitment I made to my family, it has been my intention to return to New York sometime around or after the 2020 election. I have been thinking for some time about continuing in public service after returning to New York. The U.S. Attorney position was very attractive to me given my deep respect for the work of the Southern District and its people who are dedicated to justice without fear or favor.

In an effort to facilitate as orderly a transition as possible, I began making it clear to the women and men of the Commission in the spring of 2020 that absent an unexpected development in our markets, I would be returning to my family in New York later this year. Since I was confirmed in May 2017 to lead the Commission, I have been fully committed to serving as Chairman of the SEC and have devoted my full attention to my duties throughout my tenure as Chairman. The first time this was raised with either the President or Attorney General Barr was the weekend of June 12, 2020, the weekend before my potential nomination was announced.

Question:

Please provide any and all official communication, consistent with the Freedom of Information Act, between you or any staff member of the SEC or the Department of Justice as well as any officials acting on behalf of the White House regarding this matter within 30 days of receiving this request.

Answer:

I will provide the requested information consistent with the Freedom of Information Act to your office.