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# OVERSIGHT OF THE SECURITIES AND EXCHANGE COMMISSION

## HEARING

BEFORE THE

## COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

ON

RECEIVING UPDATES FROM THE CHAIRMAN OF THE SECURITIES AND EXCHANGE COMMISSION REGARDING THE AGENCY'S WORK AND AGENDA

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# C O N T E N T S

## TUESDAY, DECEMBER 10, 2019



## WITNESSES



### Additional Material Supplied for the Record

# OVERSIGHT OF THE SECURITIES AND EXCHANGE COMMISSION

**TUESDAY, DECEMBER 10, 2019**

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
*Washington, DC.*

The Committee met at 10:12 a.m. in room SD–538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Committee, presiding.

## OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. Today we will receive testimony from the Securities and Exchange Commission Chairman Jay Clayton regarding the work and agenda of the SEC.

I thank you for your willingness to appear before the Committee today, Mr. Clayton. Your willingness to testify is essential to our oversight of the SEC.

The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

It plays a critical role in ensuring that our Nation has capital markets that the public can have confidence and trust in.

It provides information to investors so that as Americans prepare for their futures, they not only have a wide variety of financial opportunities, but they also have the information necessary to make informed investment decisions.

Chairman Clayton, you came before this Committee a year ago and assured us that you would continue to take steps to ensure that the U.S. capital markets remain the deepest, most dynamic, and liquid in the world.

I commend you and the SEC staff for your actions taken over the past year.

Actions worth mentioning include the SEC's final rule package on Regulation Best Interest, which strikes the appropriate balance of increasing transparency in investors' relationships, while preserving access to advice relationships and investment products.

The SEC also proposed modifying the accelerated filer definition to reduce the number of registrants subject to the auditor attestation requirement. I encourage the Commission to move forward quickly in a way that provides relief to all smaller reporting companies.

And this summer, the SEC issued a concept release seeking public comment on ways to harmonize the private securities offering exemption.

Regarding the concept release, I encourage the SEC to revise Regulation D to allow for general solicitation and advertising by sponsors, such as angel investor groups; the SEC should consider expanding the ability for small businesses to crowdfund; the definition of an accredited investor should be expanded and modernized to account for qualifying expertise, not simply a monetary threshold; and it is important the SEC update the definition of a family office to allow family offices and their clients who meet certain thresholds to be considered "accredited investors."

This Committee has held a number of hearings during my chairmanship discussing the need for assessing the scope and appropriateness of the proxy voting process and other aspects of corporate governance.

I commend the Commission for its actions related to the proxy process.

In August, the SEC issued guidance to assist investment advisers in fulfilling their responsibilities when voting proxies on behalf of clients and clarified that proxy voting advice provided by proxy firms generally constitutes a solicitation.

In November, after numerous roundtables and thoughtful efforts led by Commissioner Roisman, the SEC proposed two amendments to improve the accuracy and transparency of proxy voting advice and to modernize shareholder proposals.

I encourage the SEC to continue moving forward with these efforts expeditiously following the comment period.

This Committee recently held an oversight hearing on the Consolidated Audit Trail, or CAT. I have continued to express concerns regarding the personally identifiable information that is going to be collected in this consolidated database and how it will be protected.

On October 16, 2019, the CAT plan participants wrote to the SEC to request to use a CAT Customer ID instead of receiving and storing Social Security numbers in the CAT and asked to store only year of birth and firm IDs instead of full dates of birth and individual account numbers.

Chairman Clayton, you have previously expressed concerns about the information to be collected and stored in the CAT and stated that you believe the regulatory objectives of the CAT can be achieved without the most sensitive pieces of investor information. I encourage you to quickly process the request to use alternative approaches.

Finally, the SEC has made modernization a focus this year, and I look forward to hearing about your Strategic Hub for Innovation and Financial Technology and how the SEC has been engaging with initial coin offerings and other cryptocurrency-related matters.

I look forward to receiving updates on these and other SEC initiatives, including your views on when we can expect final rules in these areas.

Senator Brown.

## OPENING STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman, and welcome, Chair Clayton. Nice to see you again.

Over the past few years in this Committee, we have seen the Trump administration dismantle—we get a front-row view of this—

many of the protections that Congress put in place after the last financial crisis, putting our financial system and hardworking families around the country at risk.

The SEC has flown under the radar, but often the agenda has been the same—taking Wall Street's side over and over, instead of standing with investors saving for retirement or college or a down payment.

Taken together, the SEC's latest actions are making it harder to hold corporate executives accountable to investors and hardworking Americans.

While I appreciate the Enforcement Division's initiatives, including those to protect teachers and military servicemembers from fraud and misconduct in financial advice, you have done so much damage by adopting what you call "Regulation Best Interest." Under that rule, brokerage firms can merely disclose, but do not have to eliminate, firm-level conflicts.

It should be simple. Investment firms need to work for the people whom they serve. Americans need to have confidence that the professionals that they are trusting with their hard-earned money are working for them, not scamming them to line the firm's own pockets. You could have simply followed Congress' guidance in Dodd-Frank to create a uniform fiduciary standard for brokers and advisers, which would be the best way to give investors confidence that their interests come first. But you did not do that.

That is not the only part of Dodd-Frank you are working to undermine. Look at the SEC's proposal to amend the whistleblower program, one of the most successful programs created under Dodd-Frank. We need brave workers to stand up to corruption and abuse when they see in their workplace financial companies scamming people or engaging in other illegal activity.

The only way individual workers are ever able to stand up to powerful Wall Street firms is if we give them protection.

We have already seen a chilling effect from your proposal.

Each year since inception of the program, the number of tips has increased, in some years by more than 10 percent. But after your rule proposal in 2018 introduced a cap on whistleblower awards, the number of tips declined for the first time in 2019.

The proposed cap on awards raised so many alarm bells that you had to put out a statement to clarify. I know that "whistleblower" is a dirty word nowadays to some in this town. It always is to serial law breakers.

I do not see how you can make significant changes to a successful program like this without understanding that the decline in tips is a result of your actions and the environment this Administration has created in its talk about whistleblowers, attacking rather than protecting those who speak out against abuse of power.

As the SEC continues to take fewer actions that hold the largest financial institutions accountable, we must encourage whistleblowers to identify misconduct wherever it exists and to help uncover complex frauds.

The SEC's recent proposed rules on proxy advisers and shareholder proposals are also clear examples of the Administration taking the side of corporate interests over Americans struggling to save and invest for their future.

Both proposals make it more difficult for shareholders to hold corporate executives accountable.

The proposal on proxy advisers could make it harder for institutional investors to have timely access to independent research and analysis from the proxy advisory firms that they hire. The proposed rule would give corporations access to investors' research before the public retirement systems, investment fund managers, and foundations who manage Americans' money.

The SEC says the changes are necessary because of errors and inaccuracies, but you have provided scant evidence of those errors. Instead, the new rules would give companies a new tool to intimidate proxy advisers and threaten their independence.

The overhaul of the shareholder proposal rule would make it easier for corporate management to silence shareholders and to avoid dealing with important issues critical to investors.

The amendments could stop proposals for votes on issues such as the disclosure of corporate political spending, separating the roles of board chair and CEO, and nondiscrimination policies.

I am disappointed in the direction you have taken these rules that have for decades—for decades, through Presidents of both parties, and SEC Chairs of both parties—allowed investors to hold management accountable, all while executives are further entrenching themselves and ignoring workers and shareholders.

Protecting workers' hard-earned savings should begin with a simple concept: putting their rights first. I hope the SEC will remember that.

But over the last week and this week, we have had nearly all the financial regulators come before this Committee. We have had the Fed, we have had the FDIC, we had NCUA, today the SEC, all defending the same policies that amount to a wish list for Wall Street and corporate interests, all afflicted with the collective amnesia about what happened in the last decade or so. The President promised to look out for ordinary, hardworking people, but he and the people he has put in charge of these agencies betray those workers over and over and over again.

Mr. Chair, I would like to offer for the record this letter from the Ohio Public Employees Retirement System raising concerns about the SEC's rulemaking on proxy advisory firms.

Chairman CRAPO. Without objection.

Senator BROWN. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Chairman Clayton, you may make your presentation.

## STATEMENT OF JAY CLAYTON, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. CLAYTON. Thank you, Chairman Crapo, Ranking Member Brown, Senators of the Committee. I appreciate the opportunity to testify today about the work of the Securities and Exchange Commission.

I want to start by thanking you for your support for the Commission's mission and its people. The dedicated women and men of the Commission are our most important assets.

With the resources Congress provided last year, we have been able to lift our hiring freeze and fill around 140 new positions with high-quality individuals who I believe will serve investors well.

Since becoming Chairman, the interests of our long-term Main Street investors have been front of my mind. With that perspective, a perspective our staff has long held, I would like to highlight just a few aspects of our work over the past year.

First, modernization has been a key avenue for advancing all three aspects of our mission. In June, the Commission adopted a package of rules and interpretations designed to enhance the quality and transparency of the relationship our Main Street investors have with their broker-dealer or investment adviser. These measures bring legal duties and mandated disclosures in line with what a reasonable investor would expect, while preserving access in terms of both choice and cost to a variety of investment services and products. I am so grateful to our experienced and dedicated staff for bringing long overdue regulatory rationality and clarity to this important area.

We are also working to respond to the substantial changes that have taken place in our markets, including that more capital is raised in our private markets than our public markets, and many companies are staying private until they are very large or not going public at all.

We have expanded key aspects of the JOBS Act to increase the attractiveness of our public markets for companies while maintaining or enhancing investor protections. Increasing the attractiveness of our public capital markets is just one side of the coin. We are also exploring whether, through fund structures or other measures, we can increase the type and quality of opportunities Main Street investors have in our private markets.

I believe we should strive to ensure that an individual retirement portfolio can look like a well-managed pension fund with robust investor protection that reflects the individual nature of the account. This is a challenge, but we are making progress.

In many other areas, modernization efforts are making a difference for our investors and our markets. These efforts not only include rulemakings but also the monitoring of market function and market risk.

Turning to our inspections and enforcement efforts, I want to highlight our Teachers and Military Servicemembers Initiatives where we have focused additional enforcement and education resources. My message here is simple: If you are ripping off teachers, servicemembers, or veterans, we want to catch you, punish you, and get them their money back.

Returning funds to harmed investors continues to be a priority, and this year we returned over $1.2 billion to harmed investors. I have previously testified about some of the legal impediments that we face in obtaining funds from bad actors in situations where a fraud is well concealed, such as a Ponzi scheme. I very much appreciate the bipartisan work in Congress to address these challenges and welcome the opportunity to continue working with you to ensure that defrauded investors can get their money back.

Finally, I note that we have substantially increased our efforts to engage directly with investors, entrepreneurs, and an array of market participants. In particular, we have allocated additional resources to our retail investors and entrepreneurs that live between the coasts. I believe this type of broad, direct engagement is important.

Thank you again for the opportunity to testify today, and I look forward to your questions.

Chairman CRAPO. Thank you very much.

Chairman Clayton, as I highlighted in my opening remarks, the SEC has taken a number of critical steps to modernize the guidance and rules surrounding proxy advice, the proxy process, and shareholder proposals. This Committee has held multiple hearings and the SEC has conducted roundtables on these issues. These rules have not been reviewed by the Commission in decades, and I commend the SEC for taking these thoughtful actions based on the staff's expertise to address changes in the markets that have occurred.

In your public remarks, you have mentioned that you expect the Commission will address proxy plumbing and universal proxy. When can we expect to see actions to modernize these aspects of the proxy process?

Mr. CLAYTON. Chairman Crapo, we have taken an approach to our Regulatory Flexibility Agenda, which is if an item is on the near-term agenda, we intend to get it done within the year. Those items are on the agenda. Staff is working on them, and I would hope that we would be able to move them forward in the coming year.

Chairman CRAPO. Well, thank you. And, again, I appreciate the attention you have given it and encourage your strong focus on it to bring it to completion.

Moving to a different issue, this year Facebook announced its plan to develop a new cryptocurrency called "Libra." While the SEC is one of a number of regulators who would have jurisdiction over Libra, can you speak to how the Libra announcement has affected how the SEC and other regulators are working to be responsive to and innovative to market developments and trends like cryptocurrencies?

Mr. CLAYTON. Sure, and I appreciate the question, and the question highlights what happened with that announcement. I am not going to speak about the particular product. It is not appropriate for me to do so. But the announcement was a focal point for regulators of different types to recognize the digitization of the plumbing and other aspects of our financial system, including payment transfers. It is coming. I will say just the natural economic forces that it unleashes, taking fat out of the system, for lack of a better term, it is happening.

Now, we have to recognize that that is happening, recognize our mission—safety and soundness, investor protection, fair markets—and ensure that as that digitization takes place, we are being true to those principles. But we should not be fighting that digitization because, you know, if we fight it, it will go around us.

Chairman CRAPO. Well, thank you. That mirrors my feelings on it, and I assume when you say it is coming——

Mr. CLAYTON. I am sorry, Senator. It is here.

Chairman CRAPO. This year.

Mr. CLAYTON. It is here. It is here already.

Chairman CRAPO. I see. It is here. Yes, it is here. And as I have said many times, again, leaving aside the specific proposal of Libra, the issue is one which the United States and its allies and friends in the world community need to lead on and to set the rules of the road on rather than to let it come and develop on its own through other jurisdictions who are not as friendly to the United States, and, frankly, through other currencies than the U.S. dollar. And so I encourage you and the other regulators to focus on this carefully.

One of the first decisions that the United States has to make is who among our regulators are those who regulate and how will we regulate, as well as what will be the specifics of how we set the rules of the road. So I would encourage you to pay very close and careful attention to this.

Finally, the SEC concept release seeking public comment on ways to harmonize the private securities offering exemptions is a positive step and includes many key reforms. What are the next steps and timeline for the SEC to act?

Mr. CLAYTON. Well, the next steps that are on our agenda, a proposal around the accredited investor definition. In your opening remarks, you highlighted one of the issues with the accredited investor definition, which is it is a binary definition based on wealth. I will say it simply: There are a number of people who have the sophisticated ability to assess investments who may not meet those wealth thresholds, and we should do a better job of identifying them.

That said, the private markets have risks that are significant compared to the public markets, and we need to be cognizant of that.

Chairman CRAPO. Thank you.

Senator Brown.

Senator BROWN. Thank you.

Mr. Clayton, for a dozen years, Wells Fargo's management recommended voting against shareholder proposals, asking the company to separate the role of chairman and CEO, a corporate governance best practice. The amendments you have proposed to limit shareholders' ability to resubmit sensible proposals like this would have cutoff Wells Fargo investors after 4 years of doing that, even though in subsequent years it received support from 37 percent of shareholders. And we know separating the chairman and CEO is a sensible proposal because, after Wells Fargo found itself mired in scandal in abusing its employees, it decided to separate the positions and took a victory lap.

How do you justify a proposal like you made that could limit shareholders from continuing to push for sensible governance reforms?

Mr. CLAYTON. Senator Brown, the question that you are asking is, after a shareholder proposal has been put on the proxy and sent to all shareholders to vote on and garnered less than majority support, substantially less, how long does it stay on the proxy? Right now, the thresholds are—effectively, if you get more than 10 percent of the vote, you can keep it on the proxy indefinitely.

That rule has not been changed since the late 1950s, early 1960s at a time when communications and shareholder engagement were very different. Our proposal looks at increasing those thresholds. We have back-tested them, but, still, if you were able to garner more than one in four shareholders in favor of your proposal, the proposal would be able to stay on the proxy.

Senator BROWN. Well, you say that. That sounds good. But Commissioner Jackson's office studied data for over a decade now, from 2004 to 2018. They found the proposed rules would have excluded 35 percent of the proposals for an independent board chair, 50 percent of board diversity proposals, and 40 percent of political spending disclosure proposals. These are all areas where corporations need to be doing better. Shareholders deserve it. I hope you will consider that as you think this through where we ought to go.

Let me talk for a moment about whistleblowers. You recently tried to clarify your proposal to amend the whistleblower program and saying it would not create a cap on awards. Can you commit that the final rule will be consistent with statutory requirements and not create a cap?

Mr. CLAYTON. Absolutely, and any characterization of our proposal as a cap is completely misguided, completely misreads what our rules are. The statutory mandate is for the Commission to decide between 10 and 30 percent of the award amount how much the whistleblower should be entitled to. I can tell you that what our proposal was intended to do was to make it clear how we make those decisions, particularly at the top end and bottom end of the spectrum. I believe in transparency in how those decisions are made, and I believe that Congress gave the Commission the discretion between those bands to make those decisions. And I want to say personally—I am not speaking for the rest of the members of the Commission—I think the program has been extremely beneficial to investors, and I support it.

Senator BROWN. Well, again, you say that you support it. I believe you that you do. But I have also seen that the proposal you made has had a chilling effect. We have seen the numbers change in the last year.

Mr. CLAYTON. When people mischaracterize things and they have a chilling effect, I have to step in and clarify, which is what I did.

Senator BROWN. Well, so I guess you are arguing then that the chilling effect is gone because you clarified it.

Mr. CLAYTON. I hope so. And you cited the 5,000 number, the 5,000 whistleblower tip number, which was slightly down from last year after a long upturn. But, still, our tips, complaints, and referrals, which is people identifying issues for us, we had another 17,000 of those, and I think we investigate them—we try to target investigating them or at least initially within the first week that they are received.

Now, let me just be clear. Anybody who sees a problem, let us know.

Senator BROWN. All right. Let me just close, Mr. Chairman, with a comment from Senator Grassley. He wrote a letter to the Commission. He said, "In establishing the whistleblower award program, Congress was not concerned about a reward figure being too big. If anything, the legislative history shows that Congress was more concerned about potential whistleblower awards being too stingy."

Let me do one more—well, go ahead. I yield back.

Mr. CLAYTON. Thank you.

Chairman CRAPO. Senator Cotton.

Senator COTTON. Mr. Clayton, I want to talk today about the collapse of WeWork. That company just laid off 2,400 workers right at Christmas, 20 percent of its workforce, due almost entirely to the incompetence, greed, and possible frauds and crimes of WeWork's founder, Adam Neumann. Bloomberg reported in September that the SEC was investigating WeWork and Mr. Neumann for fraud and other securities violations.

Is the SEC investigating Mr. Neumann?

Mr. CLAYTON. We do not comment on whether we are investigating or not investigating.

Senator COTTON. OK. I thought that might be your answer, so let me put it a different way. Hypothetically speaking, if a real estate company was going public and the CEO's wife and nephew had been given positions named "chief brand and impact officer" and "head of wellness," which kind of sound like phony, made-up jobs to me, might that be something that the SEC's Enforcement Division would look into?

Mr. CLAYTON. Let me——

Senator COTTON. Hypothetically speaking.

Mr. CLAYTON. I am going to take a step back and say that transactions between the principals of companies, family members, other interests, are something where transparency is essential.

Senator COTTON. If the CEO of that same company sat on the compensation committee, in effect allowing him to determine his own salary, would that be considered something the SEC might want to look into?

Mr. CLAYTON. We are very interested in—the types of issues you are identifying should be transparent to investors in all of our public companies.

Senator COTTON. If the CEO had trademarked a common word like "we" and then sold it to his company for $6 million, is that something that would need to be disclosed and might be of concern to the SEC?

Mr. CLAYTON. Those types of transactions are required to be disclosed.

Senator COTTON. And one final hypothetical. If the CEO of that company had credibly been accused of transporting illegal drugs in a private jet across international boundaries and spending millions of dollars of his company's money on lavish parties with famous DJs and Don Julio tequila, would that be responsible governance?

Mr. CLAYTON. Let me say this: Our disclosure requirements around the background and character and activities of directors and officers of public companies require disclosure that would enable people to make those types of judgments.

Senator COTTON. So let me say this about the SEC's attorneys. I want to commend you for your work in the WeWork initial public offering. They filed a prospectus almost 9 months with you for review before it went public, and your lawyers caught many discrepancies in it, like, for instance, that they claimed that they could assume a 100 percent occupancy rate of all their buildings or some financial metric known as "contribution margin" or "community-adjusted EBITDA," whatever that means. So it is good that the SEC caught this. It is unfortunate they caught it at the last minute. We need a system that can catch this kind of fraud earlier before so many workers are injured.

All those things, though, are things that Adam Neumann either did as a matter of record or is credibly accused of having done, and at least one of them, transporting illegal drugs across international boundaries, I hope is currently under investigation by the Department of Justice for crimes, and I hope that the Enforcement Division at the SEC is investigating Adam Neumann, because today, despite all that, he is a billionaire. He received a $1.7 billion payday to walk away from the smoking rubble of his company—or, as he preferred to call it, not a company, a "state of consciousness." He was able to extract that payout because the corporate governance structure gave him ten votes per share, a kind of super voting stock that enabled him to hold his company hostage until the other investors paid him just to go away and stop destroying its value. And he is even on a 4-year consulting contract at $185 million in case they need tips on DJs or other kinds of tequila. A billion dollars is a lot of money for any executive, but certainly it is a scandal for someone who presided over the ruin of his company.

Leadership requires strong character and accountability, and that includes corporate leadership. That is what was absent in this case with Adam Neumann, and what he did to the workers at his company, aided and abetted, I would say, by some of Wall Street's biggest banks and biggest law firms. A lot of us often lament polls that show younger Americans have doubts about capitalism and are open to socialism, for good reason given the brutality and poverty that socialism inflicts on its people. But people like Adam Neumann and what he did to WeWork is the reason people in America are open to socialism.

Chairman CRAPO. Senator Reed.

Senator REED. I am tempted to ask you to respond to Senator Cotton's question.

[Laughter.]

Senator REED. Mr. Chairman, as several of my colleagues have indicated, you have proposed two major rules—one with respect to proxy advisory firms and the other related to shareholder proposals. These are rather complicated rules, and I presume you are going to receive significant numbers of letters of comment that have to be clearly analyzed. And rather than expedition, I would urge deliberation, very careful deliberation.

I think Senator Brown's comments have reflected some of the potential pitfalls in adopting these rules. I think also, too, just looking—and the Council of Institutional Investors has conducted a study that since 2016 the median number of days that an SEC rule has been promulgated, then adopted, is 416 days. That is more than a year. And those are for some that were rather innocuous rules.

So what I would ask is that you would commit to be very deliberate and very careful particularly in analyzing the comments that are coming in and do that in a way—excuse me. It is 413 days. I want to be correct—very, very careful in the review of these rules. The consequences will be significant. Can we get that commitment?

Mr. CLAYTON. Yes, and the entity you mentioned, I believe I have on my calendar for tomorrow. We are open to engagement on this. I want to hear from people of all types.

Senator REED. Very good.

Let me turn now to the issue of the status—both legal, institutional, and cultural—of some of the big accounting firms. Earlier this year, the SEC assessed a $50 million penalty to a major accounting firm for, in the words of the SEC, "altering past audit work after receiving stolen information about inspections of the firm that would be conducted by the Public Company Accounting Oversight Board." The SEC audit finds that numerous audit professionals at that firm cheated on internal training exams by improperly sharing answers and manipulating test results. In addition to the finding against the firm, a principal in the firm, the second-ranking individual, was convicted of wire fraud and other crimes. These disciplinary proceedings suggest that there may be problems, as I said—both legal, institutional, and cultural—within the accounting industry, particularly the big accounting industry.

On top of that, the Financial Times last month did a very lengthy article about the behavior in these firms, which I think you are probably aware of—you have read it, I presume—in which whistleblowers—the term arises again—came forward with experiences of harassment, bullying, and discrimination. It was a very toxic article and very unflattering to all of the industry.

So, first, do you see these issues as significant? And I hope you do. And, second, what two or three specific actions do you anticipate taking this year with respect to the issues?

Mr. CLAYTON. So, yes, Senator Reed, I do consider them very significant. High-quality financial reporting that people can rely on is the bedrock of our capital market system, and audit quality that people can count on is essential to that.

With our Office of Chief Accountant, we are engaged on a regular basis with these firms on efforts to improve audit quality, and through the PCAOB. And I want to highlight—you mentioned the Financial Times article. It is not just a domestic issue. It is an international issue. We have asked our Chief Accountant to take on an additional role as head of the monitoring group, which is trying to ensure high-quality audit standards across the globe. U.S. investors should understand that audit quality is not uniform, and, in fact, I do not believe that it is as high quality in many places outside the United States as it is here. The only thing to do there is to try and lift it, and we are trying to do that.

So I can tell you that we are engaged on a number of fronts on improving audit quality.

Senator REED. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you, Senator Reed.

Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman. Good morning, Mr. Chairman.

I want to talk to you about the Public Company Accounting Oversight Board. I think the acronym is PCAOB.

Mr. CLAYTON. Yes.

Senator KENNEDY. What does that Board do?

Mr. CLAYTON. Well, they oversee—the PCAOB really has three functions: standard setting, inspections, and enforcement.

Senator KENNEDY. Basically they review the audits of public companies. Is that right?

Mr. CLAYTON. Yes, and broker-dealers, but essentially public companies.

Senator KENNEDY. To make sure that the audits are accurate and fair and honest.

Mr. CLAYTON. Yes.

Senator KENNEDY. We have about 156 companies from our friends in China on U.S. exchanges, as I appreciate it, big market cap, about $1.2 trillion. How many of those companies, if you know, are owned by the Chinese Government?

Mr. CLAYTON. Trying to come up with a precise number to that question would be a fool's errand.

Senator KENNEDY. Sure. I am not trying to——

Mr. CLAYTON. But I will say I am certain that the Chinese Government has a significant interest in many of those companies, directly or indirectly.

Senator KENNEDY. The state-owned companies under President Xi Jinping are becoming more and more prominent than privately owned companies. How many of those Chinese companies are complying with the work of—how many of the audits of those Chinese companies are working with the PCAOB to let the PCAOB review their audits?

Mr. CLAYTON. The PCAOB requests work papers from the companies that it audits, and with respect to those companies, access to those work papers has generally not been available.

Senator KENNEDY. Right. So, basically, our friends in China are listing companies on American exchanges. They have companies audit their companies. But our PCAOB is not able to review the audits because the companies say no. Is that right?

Mr. CLAYTON. That is correct, and it is a problem.

Senator KENNEDY. What are we doing about it?

Mr. CLAYTON. Well, we are trying to remedy that directly. Recently, because remedying that directly has taken, in my view, too long, the Chairman of the PCAOB and I sat down with the heads of our big four audit firms who are generally involved through affiliates in those audits to ask what they are doing to ensure and give us comfort that the audit work they are doing is of the same quality as the audit work in other jurisdictions.

Senator KENNEDY. Has that helped?

Mr. CLAYTON. I do not know yet. But that is not a one-time dialogue.

Senator KENNEDY. Right.

Mr. CLAYTON. I expect to engage with them again, and I wanted to make sure that they understood how important this is, so we are engaging at the level of my office and the head of the PCAOB.

Senator KENNEDY. Well, I mean, we want to encourage companies from all over the world, including but not limited to China, to raise capital in the United States because our markets are very efficient. But there is a reason that God made the SEC and the PCAOB, and that is to make sure that these companies, these foreign companies, when they are audited, use auditing companies that are telling the American people and other investors the truth. And the Chinese companies do not seem to be cooperating, and it does not seem to be getting better. So a lot of investors, including but not limited to American investors, are basically flying blind, and, of course, we have had trouble in the past with auditing companies that do not really do a proper audit.

I have got a bill that I would like you to take a look at called the "Holding Foreign Companies Accountable Act." It basically says that a company has 3 years to cooperate with our PCAOB, and after 3 years, if they do not allow us to review the audits and answer our questions, they are de-listed. Do you think that would be effective?

Mr. CLAYTON. So there is one issue, and I will look at it, but just because a company is de-listed does not mean U.S. investors will not continue to invest in it.

Senator KENNEDY. That is true, but let me put it another way. It will get the attention of the foreign companies, will it not?

Mr. CLAYTON. It will. It will get the attention of investors. I think both of those things are valuable.

Senator KENNEDY. And not all of them, but many of them will be born again and start complying. Isn't that correct?

Mr. CLAYTON. I hope so.

Senator KENNEDY. Thank you, Mr. Chairman.

Chairman CRAPO. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chairman Clayton, I am increasingly concerned about the ability of foreign actors to manipulate U.S. companies through their investments, particularly in the media and technology sectors. In 2017, the U.S.-China Economic and Security Review Commission highlighted this issue when it recommended that Congress modify FCC regulations to require greater transparency regarding Chinese Government ownership of media outlets and the clear labeling of media content sponsored by the Chinese Government. And I offered a provision in the Foreign Investment Risk Review Modernization Act to make sure CFIUS is requiring foreign state-owned companies to disclose their attempts to purchase U.S. companies.

But the SEC also has a role to play. Section 13(d) of the Securities Exchange Act of 1934 requires investors who become the beneficial owners of more than 5 percent of an issuer's equity securities to report certain identifying information to the SEC. But if undisclosed or disclosed without sufficient information, such ownership stakes could undermine the free flow of information to the American people.

So my question is: How does the SEC monitor equity markets to ensure that foreign investors are not accumulating significant shares in public companies, especially in the media and technology sectors, without filing the requisite disclosures?

Mr. CLAYTON. Senator Menendez, your question is a really good one.

Senator MENENDEZ. Those are the only ones I ever ask here.

[Laughter.]

Senator MENENDEZ. I am just kidding. We have got to have fun here. We occasionally have got to have fun.

Mr. CLAYTON. Control over a public company is something our markets and investors need to know about. The 13(d) and (g) rules that essentially trigger over 5 percent ownership—not just for an individual holder but concerted efforts by others—I think are extremely important to our investors. We do try to monitor and look for violations of those rules. But I want you to know—and I am not going to get into too much detail. Our ability to track U.S. citizens who are owning companies is very robust. Sometimes when investments occur through overseas accounts, it is not as robust.

Senator MENENDEZ. And that is what I am concerned about, so I appreciate your acknowledgment of that. Would it be fair to say that you really do not have the ability to independently verify the information in a 13(d) filing, or, more importantly, to verify whether a foreign entity should have filed a 13(d) filing but failed to comply with the law?

Mr. CLAYTON. I am not going to go so far as to say we do not have the ability. I am looking for ways to enhance our ability.

Senator MENENDEZ. And so let me ask you about that. Given the need for the American public to know if their media is being funded by foreign investors, would you agree that the SEC should monitor how wrongdoing is concentrated by sector?

Mr. CLAYTON. I am not sure I follow you.

Senator MENENDEZ. By looking where you find wrongdoing, wouldn't it be of value to know which sectors those violations are taking place?

Mr. CLAYTON. Oh, sure. People in our Enforcement Division, they are very good at noticing sector-specific——

Senator MENENDEZ. Let me ask you this: When you do find a suspected 13(d) violation, how does the SEC enforce it? And what penalties are assessed against persons or entities found to have broken the law?

Mr. CLAYTON. I can think of some episodic ones off the top of my head, but to give you a general answer right now is difficult. I can get back to you on that. But, you know, we have seen violations in different contexts. In the takeover context, it is different from others.

Senator MENENDEZ. So let me give you an example. I am aware from public filings of a large radio station in the country that ultimately found that, in fact, foreign ownership because of litigation—they did not know who these creditors were, but ultimately through litigation found that foreign ownership exceeded the cap. They brought that to the attention of the FCC under their due diligence. Then there should have been a 13(d) filing by this entity, but there was not.

And so the question is: In circumstances like that—now here you have a foreign entity, a group of creditors abroad who are now owning in excess of the percentage permitted under the FCC who did not make a 13(d) filing, which is the only way a company would know whether or not they have that foreign ownership existing in their publicly traded stocks. So then the question is: What happens to that entity? If we are to have teeth at the end of the day through this 13(d) and to try to protect ourselves against foreign ownership that exceeds the allowable entity under the law, we need to have some teeth in the 13(d) process. And I really hope that as Chair you will look at that because it comes to the essence of information that we are all making decisions on based on public information of our medias. But when it is controlled by a foreign entity, you have to wonder whether or not it is just an investment or whether it is an attempt to ultimately make influences.

Mr. CLAYTON. Understood.

Senator MENENDEZ. Thank you.

Chairman CRAPO. Senator Tillis.

Senator TILLIS. Thank you, Mr. Chair. Mr. Clayton, thank you for being here. I think you and your team are doing a great job.

I did want to touch on something you and I have had a decision a couple of times over, and that is some of the proxy adviser firm rules. I know that you all have put out amendments, I think on November the 5th, and I appreciate that you are taking this seriously and moving forward with guidance and now these potential amendments.

I am particularly just interested in making sure that the proposed rules give impacted companies an opportunity to consult with proxy advisers and address any potential errors or conflicts of interest. But as you are looking forward, how do you think the proposed rule actually can help ensure that the proxy firms continue to play an important role in the marketplace, but also balance that against some of the issues that you and I have talked about in terms of errors and conflicts of interest?

Mr. CLAYTON. Let me be clear on this. Proxy advisory firms, service firms like this, they do play an important role. It is very efficient to crunch the data on a collective basis and provide that information. They can provide other services. What the proposals are looking at is really three things.

One is to make it clear that the solicitation anti-fraud rules apply. Materially misleading statements is something I think we should address.

Conflict disclosure. If you have conflicts, to the extent that they would be material to the investor, you should disclose them.

And then the last one—and, frankly, a more tricky one—is trying to improve the accuracy and completeness of the information investors from all areas have on which to make a decision.

I think all of those can be accomplished in our framework. We do it in many other areas, ensuring that we have transparency around conflicts, ensuring that the anti-fraud rules apply to people who have significant influence in our marketplace, and trying to improve accuracy. That is what we are striving for, and we welcome comments.

Senator TILLIS. Thank you. Are you looking beyond the rules that you all proposed on November 5th? Are you looking at other areas of rulemaking moving forward, automatic voting, any other priorities?

Mr. CLAYTON. Senator, I cannot say that beyond that any specifics in the area of voting other than what I mentioned, which is trying to improve plumbing. Our plumbing is fairly archaic in the proxy area—and also universal proxy. I think that there has been enough debate about that where we can now move forward with the proposal.

Senator TILLIS. Just one other thing, because I have heard some concerns over litigation and how it may increase in this space. Have you looked at this? Do you have any things that you would be looking at at the SEC?

Mr. CLAYTON. I am happy to hear from people who have a concern about an increase in litigation. To be clear, the proposal makes it clear that there is no new right of action or private right of action created by the proposal.

Senator TILLIS. Another area I want to touch on, because I know in here we have had some of our members and I think some of the folks on the Commission have expressed some concern about buybacks, stock buybacks, and potentially placing limits on that. I for one think that it is a business trying to figure out the best way to deploy its capital. Would any kind of restrictions or additional restrictions on buybacks, what would the consequences be to mom-and-pop shops—or I should say mom-and-pop investors, over time if we limit that optimization of deployment of capital, what negative impact could it have on the average investor?

Mr. CLAYTON. It is difficult to say with any degree of precision. I agree with the premise of your question, which is capital allocation decisions—whether to buy a company, whether to invest in a new line, whether to pay a dividend or whether to buy back stock—those are board of director decisions, understanding the idiosyncracies of the company and what they believe is best for the long-term interests of the company.

To put a point on it, I am not qualified to make that decision for them.

Senator TILLIS. I agree. Thank you. Not that you would not be in the board room, but in your current capacity, I do not think it is an appropriate role in your current capacity. Thank you very much.

Chairman CRAPO. Senator Smith.

Senator SMITH. Thank you, Chair Crapo. And hello again. Nice to see you again, Mr. Clayton.

I would like to follow up on the line of questioning that Senator Brown and Senator Reed started around these shareholder proposal rules. Last month, the SEC voted on party lines to adopt these two rules that I think will make it harder for investors to seek votes on shareholder proposals, so I am concerned about this. And I wanted to ask you about something specific to this.

In your statement when the Commission approved these restrictions, you cited several public comment letters, and you said something to the effect of how these letters struck you the most because they came from long-term Main Street investors, including an army veteran, a marine veteran, a police officer, a retired teacher, and a public servant and a mom. And this is all great, except, of course, it turns out that there is some question about the validity of these comments.

According to Bloomberg News, several of the letters that you cited were not actually Main Street investors at all, and they did their investigation, which found out that the retired teacher said she never wrote the letter, and the military vets, it turned out that they were the brother and the cousin of the chairman of this Virginia advocacy group that was paid for by the corporate supporters of this SEC initiative. And Bloomberg went on to say that one of the retirees said that he did not write the letter bearing his name, and the public servant cited said that she had just allowed a public affairs firm to use her name without even knowing what it was about.

So I wanted to just ask you a little bit about this. Given that you cited these letters, has this had any effect on your thinking about whether this is a good idea?

Mr. CLAYTON. Well, a couple of things. One is we are having an investigation done of this issue. I am just going to leave the specifics of that.

I am very interested in hearing directly from individual investors, in particular directly, not filtered by groups. One of the reasons that we have conducted a large number of town halls and did so in connection with our standards of conduct rulemaking is that when you interact directly with investors, you get a lot of good information.

Senator SMITH. I would agree with that.

Mr. CLAYTON. So during this comment period, I encourage as many individual investors as they can to share their thoughts with us, and we will be doing town halls where they will have the opportunity to speak directly to me.

Senator SMITH. So you are investigating these sham letters from the public to try to understand what happened here and how they got included?

Mr. CLAYTON. I am not, but we were in contact as soon as the Bloomberg—I should not say "as soon as"—but very shortly after the Bloomberg article came out, we contacted our General Counsel and the Office of Inspector General.

Senator SMITH. Do you think it should be illegal to submit comments under a false identity, as happened here?

Mr. CLAYTON. You know what? I am not going to get into that here. I think the comment process is an open process. To the extent things happen, I do not think that—well, I am just going to leave it at that for now.

Senator SMITH. OK.

Mr. CLAYTON. Let us see what happens with the investigation.

Senator SMITH. I am certainly glad to know that you are investigating this. I think that that is really important. And if you are basing decisions about what to do on comments and public interactions that end up to be fueled by, you know, corporate advocacy groups, that I think is a problem.

Mr. CLAYTON. That is why we have an open APA process and comment period.

Senator SMITH. OK. Let me ask you another question. I also serve on the Agriculture Committee, and so this question relates to that to a certain extent. In August, the Commodity Futures Trading Commission agreed to settle allegations that the food giant Kraft had manipulated the wheat market. And the settlement agreement they approved was unique because it included no factual findings or conclusions of law and prevented the Commission from making any public statements about the settlement. And this is very concerning to me because I think that U.S. citizens should have the right to know what Federal agencies are doing when they are settling cases.

So my question to you is: How common is this practice? Is it happening at all that you are aware of at the SEC?

Mr. CLAYTON. You are asking a very open-ended question. I am not aware of any situation of the type that you describe. I want to make sure I carve out any kind of national security or intelligence area from what I am saying. That is appropriate in these types of circumstances. But as far as ordinary commercial actors, I am not aware of any. I will leave it at that.

Senator SMITH. OK. That is a great concern to me as well, so thank you.

Thank you, Mr. Chair.

Chairman CRAPO. Thank you.

Senator Moran.

Senator MORAN. Chairman, thank you. Thank you, Ranking Member.

Mr. Chairman, thank you for joining us. I will start by commending you for your leadership at the SEC. I appreciate the agenda you have helped accelerate over the last year. I also appreciate the openness of your comments today, your responses to questions and the conversations we have had in the office and as members of this Committee.

I do want to raise a concern about what I believe is occurring, an increased use of enforcement initiatives, often referred to as "regulation by enforcement" At least one Commissioner recently asserted that when the Commission sees a widespread problem affecting investors, it should "issue its own guidance or promulgate a rule and put an end to the problem before it hurts investors" under the belief that it is better for investors than a large enforcement initiative and provides regulated industries with appropriate notice of what the SEC expects from them.

Do you agree with that or have a comment as to what was being conveyed there?

Mr. CLAYTON. So, Senator, your question highlights one of the challenges of regulating a broad market. If you see widespread conduct that is clearly problematic, there is no reason to provide guidance. You just go out and deal with it. If you see widespread conduct that is a new area and people reasonably could conclude one way or the other, my view is that guidance, and loud guidance, is the best way to deal with that. Life is complicated. A lot of things fall somewhere in between.

I think one of the things you and I have talked about is the Share Class Initiative. I think that where we were was much closer, if not all the way at the end of the spectrum. People have different views, but I appreciate that spectrum, and I think our Enforcement Division and our Inspections Division understand that. Part of my job is to make sure they understand that and make the appropriate selection how to pursue conduct that needs to improve.

Senator MORAN. Mr. Chairman, in that regard, you have said before that staff statements and guidance do not create enforceable legal obligations. Yet I think we often see the SEC point to risk alerts and enforcement proceedings brought against other industry participants as justification for appropriate notice.

I will use the February 2018 Share Class Selection Disclosure Initiative regarding disclosures for conflicts of interest from certain fee arrangements as an example. SEC staff pointed to a 2016 risk alert as evidence that the industry was given sufficient notice about what the SEC expects from regulated firms in disclosures, such as the use of "may" versus "will." However, I understand that the initiative has penalized firms for activity dating back to 2014 and beyond—in other words, previous to the notice that you are claiming occurred.

Is there something here that I should be worried about?

Mr. CLAYTON. I do not think there is something here in particular that you should be worried about, but I do think that the principles you articulate are something that we should always be concerned about. We should not be in the business of "gotcha," but we do need to be in the business of making sure that we enforce our laws. And if the Commission feels some way about it, we, the Commission, should articulate it. We should not be relying on staff guidance. If there is to be a change in the law, that should come from the Commission, or change in the regulation.

Senator MORAN. I fully support the initiative's objectives to provide important protections for our retail investors. That is not really the issue. I do not know exactly what due process means in today's world, but notice has always been something that is included in due process, and in order to—one, I would hope that those that you have the ability to regulate, if they knew what the position of the SEC was, they would comply voluntarily. That is a positive in and of itself. And, second, for there to occur something in which there seemingly was no notice denies them the ability to voluntarily comply and eliminates the opportunity for them to have due process.

Mr. CLAYTON. Understood.

Senator MORAN. Chairman, thank you.

Mr. CLAYTON. Thank you.

Chairman CRAPO. Senator Cortez Masto.

Senator CORTEZ MASTO. Thank you. Chairman Clayton, thank you for appearing today. We appreciate it.

I want to talk to you a little bit about my concern and what can be done and what you are doing to prohibit bequests from clients, so let me give you an example. I sent a letter along with some of my colleagues to FINRA to limit the ability of broker-dealers and other financial advisers to inherit money from their clients. A big concern. I know as a former Attorney General there is fraud oftentimes associated with that.

Now, granted, I understand that some family members, there could be exceptions for certain relationships, but most importantly, I am concerned about the fraud that is associated with it.

So I guess my question to you is twofold. Do you think that regulators should prohibit financial advisers to receive bequests from their clients? And what are you doing to address that issue?

Mr. CLAYTON. So on the specific question, I am going to have to—on the contours of it, I am not going to comment, but on the area of our elderly, many of whom are in a position where they may have diminished capacity or not have support, we are very concerned about that.

Let me just say that the fact pattern that you posit of a trusted adviser receiving an inheritance, that is something that strikes me as very difficult to understand how that could happen and worries me.

What specifically we are doing about it? We are doing a lot at the SEC to recognize that many of our investors are getting older, and we need to deal with that fact, including implementing the Senior Safe Act, which allows broker-dealers to hold off on distributing funds if they think that something inappropriate is going on. But I am happy to engage with you further on this issue.

Senator CORTEZ MASTO. I would appreciate that because I think it is an issue that needs to be addressed, and I look forward to seeing what you are doing to address the issue.

I also appreciate your attention to preventing retail investors from falling victim to fraud. FINRA has proposed a rule to make it more difficult for dishonest brokers and their firms to operate. Again, last month, along with my colleagues, we sent a letter to FINRA asking them to strength its proposed Rule 4111 to expel firms and brokers with a history of fraud. I know FINRA is finalizing this rule now. My understanding is it is going to be passed to the SEC for you to take a look at.

I guess my question is just will you ensure that Rule 4111 is clear that unscrupulous financial professionals cannot continue to operate. And then, second, when will the SEC approve—or when do you anticipate taking a look at that rule and approving it or having a comment with respect to 4111?

Mr. CLAYTON. Let me say generally our view is it is a privilege to work in our securities markets. It is a privilege that you can lose and should lose if you misbehave. I want to be careful not to prejudge. I have not seen the text of the rule. But I will say I have long been supportive of the concepts that are in that rule, including that—let me put it this way: If you are going to hire somebody who has a history, the registration and other requirements that FINRA imposes should reflect that you are taking more risk than someone who does not.

Senator CORTEZ MASTO. Thank you. And then, also, I appreciate the concern around digital currency. This is an area that I think, along with the Chairman, I am paying very close attention to, and I know your comment. You said it is here, we should not go around it. I absolutely agree. And I am hopeful that as we move forward that you are putting resources to addressing and taking a look at this and what can be done, but also at the same time coming back to Congress and talking to us about what we can do working with you to really be prepared for the future of digital currency, because it is coming. I think we need to be prepared for it. So thank you.

But I do have one final question with respect to the enforcement. I was glad to see that the SEC had taken action against cryptocurrency firms that failed to comply with requirements for raising funds from investors. However, according to a recent article in the Wall Street Journal, three of the companies missed their deadline to repay people who bought their token.

What is the SEC doing about cryptocurrency companies that fail to comply with the SEC settlements, one? And then, two, do you have enough resources within the Enforcement Division to address these issues?

Mr. CLAYTON. OK. Let me try and summarize what can happen with settlements sometimes. We try to structure settlements in a way that tries to get the most money back to investors over time. Sometimes that means allowing payments over time, the enterprise to continue and to try to get the money back. And sometimes they just fail because they were not good companies to start with. I think some of that paradigm applies to the situations that you identified, or at least some of them.

In terms of resources, I think we can do our job. When I first took this job, I did not know what I would do with significant additional resources. Now I feel better to the extent we can have additional resources, particularly in some of these emerging areas. We can put them to good use, but we can do our job. That is how I feel about it.

Senator CORTEZ MASTO. Thank you.

Chairman, thank you.

Chairman CRAPO. Thank you.

Senator Cramer.

Senator CRAMER. Thank you, Chairman Crapo. Thank you, Chairman Clayton, for being with us and for your candor.

I want to drill down a little bit on the Consolidated Audit Trail, the CAT issue, which is, of course, designed to collect a lot of personal sensitive financial information—in fact, information on every retail brokerage client in our country, as I understand it, which should amount to, by my calculations, over 100 million clients. In and of itself, you know, that much data, that much sensitive information compiled in one place has its challenges. But in addition to that, the SROs, as I understand it, with some 3,000 people and 24 organizations, will have the ability not only to access it but then to be able to bulk it downward into their systems.

I did not used to be paranoid, but I have come to a point where the ability for institutions to secure that much data, especially sort of this broad application of it, concerns me. And I would love for you to help me feel more comfortable with what the SEC is doing to protect against attacks and cyber challenges with that kind of a risk.

Mr. CLAYTON. The CAT is a good example of, I think, how we should look at a lot of large data projects. I agree with your concern, and the question is, the fundamental question is not what data would we like to have, but what data do we need to do the job? You know, we are going through a process with the SROs and others. I think we can significantly limit—I have said, just speaking for myself, phone book information from individuals should enable us to do our job and have the CAT function in the way it was envisioned to function. So that reduces the risk because the data is not as sensitive. And then, of course, the other side of the coin is what type of security protections do you put in place, and how do you ensure that those security protections can evolve as the threats evolve?

That is kind of a general summary, but we are working on reducing the sensitive data and ensuring that folks have insight into that, and we continue to improve the security protections.

Senator CRAMER. To just drill down a little further, my understanding is that the firms are required to sign this CAT Reporter or agreement, which in essence shields the SROs from liability. And anytime we start shielding institutions or individuals from liability, I always ask why. Why is that necessary? If the safeguards are in place—you know, it only adds to my insecurity, if you will, Mr. Chairman.

So from my point of view, this is highly risky, and I believe a breach will eventually happen, but I hope the SEC can prevent that, obviously.

Mr. CLAYTON. I am aware of the issue around the allocation of potential liability, and I am actually meeting tomorrow with representatives of the SRO community and what I will call the "dealer community" to discuss the issue.

Senator CRAMER. I appreciate that. Thank you.

Mr. CLAYTON. A busy day tomorrow.

Senator CRAMER. Sounds like it.

Chairman CRAPO. Senator Schatz.

Senator SCHATZ. Thank you, Mr. Chairman. Chairman Clayton, thank you for being here.

I want to ask you about the Commission's engagement on the work of the task force for climate-related financial disclosure. How are you working with the task force?

Mr. CLAYTON. So we are working—there are international bodies. There is FSB, IOSCO, and I will also just put the EU there. We are working with all of them on this issue because market disclosure issues of this type are global issues. They are not just domestic issues. And I would say on medium, light, heavy, we are fairly heavily engaged on this as compared to some other issues.

Senator SCHATZ. And, specifically, what are you doing with them?

Mr. CLAYTON. Well, me specifically?

Senator SCHATZ. I mean the Commission.

Mr. CLAYTON. Working on the reports, working on proposals, but it is not just that. I think it goes beyond that. I personally have recently met with Valdis Dombrovskis from the EU, spoken with Mark Carney, working through Randy Quarles, trying to bring some what I would say is—I am going to use Mark's words; I think it is very good—"decision-useful information" to the marketplace in this regard. I think that is a good way to look at it.

Senator SCHATZ. And you think that we are not quite there yet?

Mr. CLAYTON. It is hard. I think we are not quite—yeah, I think it is hard.

Senator SCHATZ. Are you actively enforcing your 2010 guidance on climate disclosure?

Mr. CLAYTON. If what you mean by "actively enforcing" it is are we actively monitoring companies to see if they are following it, and to the extent they are not, addressing that, I think the answer is a clear yes.

Senator SCHATZ. I think one way you could more actively enforce it would be to put issuers on notice that this is something that Division of Corporation Finance will be examining.

Mr. CLAYTON. Let me say we examine for this when we examine filings.

Senator SCHATZ. Thank you. I think people listen more carefully if you say, "We examine for this."

Mr. CLAYTON. To be clear, we examine for this and have been examining for it. And I would encourage people to look at the comment letters that eventually become available publicly.

Senator SCHATZ. I divide this problem into a number of categories. The first is sort of politics, and I think we are mostly—in terms of your Commission, we are mostly through that part of the problem, but there are a couple of other problems. One is that we have to develop instruments and processes that kind of work across platforms and across the planet so that when you are doing disclosures, you are comparing apples to apples. But the other part of this is whether or not you as an agency are leading versus sort of waiting for TCFD and others and seeing how things play out. So in the ecosystem that is working on this, would you consider the SEC a leader or a follower or a participant? Where do you put yourself in this?

Mr. CLAYTON. Definitely a participant, and I would say a leader through that decision-useful lens, including trying to articulate ways that we can use the information that is being generated to further what I would say is our monitoring oversight.

Senator SCHATZ. There are a bunch of voluntary disclosure regimes, as you know, TCFD and the Carbon Disclosure Project, and some organizations that come under your jurisdiction are making voluntary disclosures under TCFD and others, and then they make a separate sort of less informative disclosure as it relates to climate risk to you. Do you consider it appropriate for the Commission to then look at those voluntary disclosures and incorporate into your risk analysis?

Mr. CLAYTON. Do we examine for this? Not just in this area, but in many areas, we look at a company's public disclosure, the required statutory disclosure in their annual report, 10–K or whatnot, and compare it to what they are saying other places, and often ask companies, "Please make sure that you reconcile these for us," to the extent they do not look consistent and tell us why there are any inconsistencies. That is something that we do.

Senator SCHATZ. And you think you can be useful—in terms of being decision-useful, there are a number of ways to look at that, but one of the problems is you have just got different ways to disclose climate-related risk. Do you think the SEC can lead or at least assist in developing a more consistent, comparable, thorough disclosure for climate risks?

Mr. CLAYTON. Let me say this: I think we have a great deal of expertise in assisting registrants in disclosing risks in a way that investors can use it, and we are trying to bring that to bear in all areas of what we do, including this.

Senator SCHATZ. Thank you.

Chairman CRAPO. Senator Rounds.

Senator ROUNDS. Thank you, Mr. Chairman. Mr. Chairman, good morning.

I want to follow up a little bit on the issue of the Consolidated Audit Trail. It seems to me that you have suggested that there will be modifications or at least we could expect modifications based upon the amount of data that might be collected. I am concerned because clearly there is a very high probability that there would be breaches. Just as an example, having an employee take home a notepad with data on it, any type of a process in which employees can gain access, and then simply lose it, if nothing else. These all seem to be ways in which data could be lost. We are talking about the consolidation of data from a lot of different entities into one location, which seems to be making for a prime opportunity for nefarious activities.

My question is, number one, when we start talking about the limitation of liability, as Senator Cramer has suggested, it bears to mind that somebody still has that loss, and the question then is: Do you believe that the rules as they are currently being laid out or at least the guidelines as we are currently seeing them, where there are limitations for some, are these fair the way that they are set up to limit the liability? And are you going to go so far as to maybe review that process, the limitations that are currently being put in place today?

Mr. CLAYTON. You know, the short answer is yes. Do you want the longer answer?

Senator ROUNDS. Yes, I do.

Mr. CLAYTON. The longer answer is your premise is right in that when you allocate responsibility, you generally try to allocate it to the people who can best address the risk, who are responsible for it, and that is something that is in my mind as I look at these things.

Senator ROUNDS. OK. Well, I just want to bring attention. I really do think this is a serious issue, and it does not mean that you do not need a Consolidated Audit Trail, but if you are going to go that route, then it has got to be something in which data has to be kept in some kind of a secure entity. And if you cannot do that—and I am not sure that you can—then perhaps we should be looking at a more limited amount of data, and it sounds to me like you are looking at that, but then along that line, making certain that where the possibility of risk is at, the blame does not leave that location. So there is a responsibility and an authority which are combined for the protection of that risk.

Mr. CLAYTON. Understood.

Senator ROUNDS. OK. I want to go back a little bit. I listened with interest, and I want to just give you an opportunity, should I say, to perhaps clarify the suggestion that Libra might be ridiculous. And I want to go into this with the following: I know that there have been a number of folks that have wondered whether or not Libra, which I think was an attempt to do something different—if we simply walk away from that thing and simply say that is ridiculous or the product is ridiculous, which is the way that I heard it, I think we pick winners and losers.

Mr. CLAYTON. I am not passing judgment on any—if my comments were that Libra or any product is ridiculous or not ridiculous, I can tell you what. I do not know. What I do know is there is a great deal of, how do I say it, friction in the marketplace that digitization can reduce. We need to make sure that, to the extent that happens, we are still being true to our statutory missions across the Federal financial regulatory community, and investor protection, efficient markets, for the banking regulators—I do not want to speak for them, but safety and soundness, *et cetera*. We cannot lose sight of those things because of a new technology. But we also cannot rely on old technology to ensure that we do those things.

Senator ROUNDS. That is right. And, you know, you are looking at definitions right now that come from a 90-year-old law. Let me just maybe cut to the chase on it. Do you delineate, do you see a difference between and do you see it as a separation between a cryptocurrency and perhaps a digital currency? Do you see this as being the separating issue where you literally have a digital currency today in some respects backed by a sovereign versus a crypto which may not be backed that way? Is that what you are—you have an obligation, I guess, in this case as a regulator to where you may be looking at both.

Mr. CLAYTON. Let me say this: I think there is a lot going on there. It is complicated. We already have a great deal of digitization in our financial system. I do believe there is a difference between a sovereign-backed medium of exchange and a private medium of exchange.

Senator ROUNDS. I agree with you, and I just want to make sure you have got the tools necessary to look at both, if that is your charge.

Mr. CLAYTON. Yeah, I want to say to you and this Committee I have heard you, and I appreciate that, to the extent we need something, we should be engaged with you. And I thank you for that.

Senator ROUNDS. Thank you. Thank you, Mr. Chairman. Thank you, sir.

Chairman CRAPO. Senator Van Hollen.

Senator VAN HOLLEN. Thank you, Mr. Chairman. Welcome, Mr. Chairman. A couple things.

First, I want to associate myself with Senator Kennedy's remarks about our legislation require that Chinese companies listed on our exchanges meet the same audit requirements we require of everybody else. It seems to be common sense.

Second, on a number of occasions when we have had hearings, I have raised with you the issue of the strong correlation between the timing of insider share selling and stock buybacks. Since we last discussed that, Commissioner Jackson and others have presented even more evidence that the timing is not a coincidence, that executives may be manipulating the timing to fatten their returns at the expense of their shareholders. And I am disappointed that you and the Commission have not moved forward more rapidly to investigate this. And I am disappointed that instead you are focused on strengthening the hand of already very strong CEOs and corporations at the expense of their shareholders in many cases with the proxy advisory regulation you have proposed. And this seems to be an answer in search of the problem.

There are some issues. We all know what you describe as sort of the plumbing and trying to figure it out. I also agree with the conflict of interest provisions. But what you are doing is saying that if I go out and hire somebody, an independent proxy adviser, to make recommendations to me about how I should vote with my shares, that proxy adviser then has to go to the company and the

CEOs and get them to essentially comment on them and they get to have a number of reviews.

You know, I really do not need a nanny to advise me. If I do not want to hire a proxy adviser, I do not have to. But what troubled me even more was you did try to present this as sort of a concern of Main Street investors. When you rolled this out, you attempted to create the impression that this was something a lot of Main Street investors care about. I can tell you—I sit on the Committee, I have served in the House, I have been in the Senate—I have not had a Main Street investor ever come up to me and say this is a concern of theirs.

Now, if there are, I look forward to it. But you got duped when you rolled out that statement. Senator Smith asked you about that, but the reality is, in addition to the fake letters that she mentioned, a teacher who you cited who apparently says now she did not write the letter, there were a number of letters you cited that were clearly orchestrated by a group called "60 Plus."

Now, for those of us who have been around here for a little while, we know what 60 Plus is. It is a dark-money front group that corporations use for messaging. They do not have to disclose their donors. It sounds great. They make it sound like they are taking care of seniors. But we have found out some of their donors include corporations like Chevron and Exxon, and so it turns out that a number of the letters you cited were from relatives of the head of 60 Plus. Are you aware of that now?

Mr. CLAYTON. I have now heard this—I was not familiar with the group 60 Plus.

Senator VAN HOLLEN. So were you aware that the retired couple you cited are the mother- and father-in-law of the head of the 60 Plus association? Are you aware of that now?

Mr. CLAYTON. Only because you just told me.

Senator VAN HOLLEN. Are you aware they told the reporter they had no connection themselves with the letter?

Mr. CLAYTON. No.

Senator VAN HOLLEN. Are you aware that the military veterans that you cited are the brother and cousin of the chairman of the 60 Plus association?

Mr. CLAYTON. If you say so.

Senator VAN HOLLEN. Mr. Chairman, look, if a company had done this, we could go after them for deceptive practices, for misleading statements. I know you did not intend to do that, but you became the vehicle for that, and you became the vehicle for that as you tried to roll out this provision with the patina that it was looking out for Main Street investors. Wasn't that your intent?

Mr. CLAYTON. Regardless of this colloquy, I still believe we are looking out for Main Street investors.

Senator VAN HOLLEN. It does not appear to me to do that. This is the top priority—this in and of itself does not make it bad, but it does mean you should be cautious before you say it is the top priority of Main Street investors. This is the top priority of a lot of corporate CEOs who do not want to be second-guessed by proxy advisers. Isn't that true?

Mr. CLAYTON. So, look, let us see what we agree on. Disclosure conflicts.

Senator VAN HOLLEN. Yeah, so I said in my remarks that is fine. That is number one. There are two and three where you require everybody——

Mr. CLAYTON. OK, we will get to three.

Senator VAN HOLLEN. OK.

Mr. CLAYTON. Disclosure conflicts. Take commensurate responsibility for what you are saying. The anti-fraud rules should apply. OK?

The last one, I will tell you I am open for discussion on all of them, the last one on how we ensure better accuracy, I am very open. If people think that what we are proposing is too onerous but we can get to improved accuracy in another way, I am open.

Senator VAN HOLLEN. As you know, there is an ongoing lawsuit right now on this issue because the basis for your rulemaking is that the proxy solicitation—that proxy advice is the same as a proxy solicitation.

Mr. CLAYTON. Well, it depends on how——

Senator VAN HOLLEN. My understanding is it was 3–2 vote. So——

Mr. CLAYTON. There are different levels, but——

Senator VAN HOLLEN. So there is an ongoing lawsuit, and that goes to the heart of the question of your authority. So my question is: Are you willing to delay the rulemaking process pending the outcome of this lawsuit?

Mr. CLAYTON. I am not going to commit to that today.

Senator VAN HOLLEN. What if you go through this process and then the lawsuit says there was no authority to do it?

Mr. CLAYTON. Unfortunately, that is a risk that we run. The advice we have gotten is that we should be very comfortable with where we are.

Senator VAN HOLLEN. So just in closing, Mr. Chairman, my biggest concern right now is the way you tried to present this when you rolled it out. And you did get duped——

Mr. CLAYTON. I am not—I am not backing away from the fact that we want to do what is in the best interest of our long-term——

Senator VAN HOLLEN. That is a great goal, but, Mr. Chairman, the letters you cited were orchestrated by a dark-money group that is funded by many of the corporations that stand to benefit from your proposal. They are advocating for that. They are using this group to funnel their money through, and you became their mouthpiece.

So I do think it is important for you to retract those statements, to let the public know that you were duped—I am not—you did not intentionally deceive anybody, but the letters that you used to make the case that this was for Main Street investors were, in fact, orchestrated by a group that is funded by some of the very big corporations that are pushing hard for the rule, and that is a deceit on the public, not from you but you became the vehicle for that. And I hope you will make it very clear that you find that outrageous, that the people who hope that you are going to do this—these are people who are pushing hard for this to happen. And you became the vehicle for their fraudulent attempts to make it sound like this was all about Main Street investors.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you. And Senator Brown would like to ask another question.

Senator BROWN. First, a comment on—I thank Senator Van Hollen for his comments and his back-and-forth with the Chairman. We hear always in this Committee, particularly from that side of the aisle, about mom-and-pop investors, and all the Trump nominees want to take care of the little guy and the mom-and-pop investors. And I think Senator Van Hollen's investigation and comments show that oftentimes the mom-and-pop investors have some front to not be conspiratorial in this town and in these days, but that it is pretty clear that has been what is happening for years with so many of these dark-money groups.

Let me take a slightly different place, and I will ask one question, Mr. Chairman. Earlier in my opening statement, I think I mentioned that—I asked for inclusion of a letter from the Ohio Public Employees Retirement System, and I appreciate that the Chairman graciously did that. They weighed in last year at the SEC roundtable on proxy voting issues. They raised concerns that changes to the rules would make proxy advice more expensive, less independent, less timely, and could hurt public pension participants. The proposal you issued last month would do all of those things under the pretense of improving conflict disclosure, eliminating errors, but the rule would go far beyond that by giving companies two bites at the apple to review proxy research before it gets to investors that are paying for it.

How do those sweeping changes that institutions did not ask for and that could compromise the research they are paying for, how does that benefit investors?

Mr. CLAYTON. Well, Senator, I do think that robust conflict disclosure, when it is material, does benefit investors. They should know what incentives people have when they are making statements. I do believe that if you are making statements in an attempt to influence or solicit votes, general anti-fraud principles should apply.

On the last one, how to increase accuracy, like I said to Senator Van Hollen, I remain open to ways to deal with that. But let us just be clear what we are trying to achieve here. We are trying to achieve that the investor has a robust mix of information on which to make an investment decision. And if that comes from a proxy advisory firm in combination with the company, so much the better.

Senator BROWN. Thank you for that. It looks to a lot of us that we, again, tip the power too far in favor of companies and management needs to be more accountable, not less, and shareholders need more tools, not fewer. And the direction that you seem to be going is not that.

Mr. CLAYTON. Let us also be clear, we are not—say on pay, other engagement mechanisms, this is—what I want to achieve here is that people who are making the investment decision, the voting decision, have as good a mix and as accurate a mix of information as they can have. That is what I want to achieve.

Chairman CRAPO. Thank you.

That concludes the questioning today, and, again, I want to thank you, Chairman Clayton, for being here today and also for your strong leadership at the SEC. I appreciate it.

For Senators who wish to submit questions for the record, those questions are due on Tuesday, December 17th, and I encourage you, Chairman, to please respond as promptly as you can to them.

This is our last hearing for this Congress—unless we schedule another one—and we have had a lot of productive hearings. I think that we should—I want to thank all of our Senators for making that happen and also our witnesses and those who have come before us. And it has laid the foundation for what I expect to be a significant amount of productive effort.

With that, this hearing is adjourned.

Mr. CLAYTON. Thank you.

[Whereupon, at 11:44 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

**PREPARED STATEMENT OF CHAIRMAN MIKE CRAPO**

Today we will receive testimony from Securities and Exchange Commission Chairman Jay Clayton regarding the work and agenda of the SEC.

I thank you for your willingness to appear before the Committee today. Your willingness to testify is essential to our oversight of the SEC.

The mission of the SEC is to protect investors; maintain fair, orderly and efficient markets; and facilitate capital formation.

It plays a critical role in ensuring that our Nation has capital markets that the public can have confidence and trust in.

It provides information to investors so that as Americans prepare for their futures, they not only have a wide array of financial opportunities, but they also have the information necessary to make informed investment decisions.

Chairman Clayton, you came before this Committee a year ago and assured us that you would continue to take steps to ensure that the U.S. capital markets remain the deepest, most dynamic and liquid in the world.

I commend you and the SEC staff for the actions that have been taken over the past year.

Actions worth mentioning include the SEC's final rule package on Regulation Best Interest, which strikes the appropriate balance of increasing transparency in investors' relationships, while preserving access to advice relationships and investment products.

The SEC also proposed modifying the accelerated filer definition to reduce the number of registrants subject to the auditor attestation requirement. I encourage the Commission to move forward quickly in a way that provides relief to all smaller reporting companies.

And, this summer the SEC issued a concept release seeking public comment on ways to harmonize the private securities offering exemption.

Regarding the concept release: I encourage the SEC to revise Regulation D to allow for general solicitation and advertising by sponsors, such as angel investor groups; the SEC should consider expanding the ability for small businesses to crowdfund; the definition of an accredited investor should be expanded and modernized to account for qualifying expertise, not simply a monetary threshold; and it is important the SEC update the definition of a family office to allow family offices and their clients who meet certain thresholds to be considered "accredited investors."

This Committee has held a number of hearings during my chairmanship discussing the need for assessing the scope and appropriateness of the proxy voting process and other aspects of corporate governance.

I commend the Commission for its actions related to the proxy process.

In August, the SEC issued guidance to assist investment advisers in fulfilling their responsibilities when voting proxies on behalf of clients and clarified that proxy voting advice provided by proxy firms generally constitutes a solicitation.

In November, after numerous roundtables and thoughtful efforts led by Commissioner Roisman, the SEC proposed two amendments to improve the accuracy and transparency of proxy voting advice and to modernize shareholder proposals.

I encourage the SEC to continue moving forward with these efforts expeditiously following the comment period.

This Committee recently held an oversight hearing on the Consolidated Audit Trail, or CAT. I have continued to express concerns regarding the personally identifiable information that is going to be collected in this consolidated database and how it will be protected.

On October 16, 2019, the CAT plan participants wrote to the SEC to request to use a CAT Customer ID instead of receiving and storing Social Security Numbers in the CAT, and asked to store only year of birth and firm IDs instead of full dates of birth and individual account numbers.

Chairman Clayton, you have previously expressed concerns about the information to be collected and stored in the CAT and stated that you believe the regulatory objectives of the CAT can be achieved without the most sensitive pieces of investor information. I encourage you to quickly process the request to use alternative approaches.

Finally, the SEC has made modernization a focus this year, and I look forward to hearing about your Strategic Hub for Innovation and Financial Technology and how the SEC has been engaging with initial coin offerings and other cryptocurrency-related matters.

I look forward to receiving updates on these and other SEC initiatives, including your views on when we can expect final rules in these areas.

## PREPARED STATEMENT OF SENATOR SHERROD BROWN

Thank you Chairman Crapo, and welcome Chair Clayton.

Over the past few years, in this Committee, we have seen the Trump administration dismantle many of the protections we put in place after the last financial crisis, putting our financial system and hardworking families around the country at risk.

The SEC has flown under the radar, but often the agenda has been the same—taking Wall Street's side over and over, instead of standing with investors saving for retirement or college or a down payment.

Taken together, the SEC's latest actions are making it harder to hold corporate executives accountable to investors and hardworking Americans.

While I appreciate the Enforcement Division's initiatives, including those to protect teachers and military service members from fraud and misconduct in financial advice, you've done so much damage by adopting what you call "Regulation Best Interest." Under that rule, brokerage firms can merely disclose, but don't have to eliminate, firm-level conflicts.

It should be simple—investment firms need to work for the people they serve. Americans need to have confidence the professionals that they're trusting with their hard earned money are working for them, not scamming them to line the firm's own pockets. You could have simply followed Congress's guidance in the Dodd-Frank Act to create a uniform fiduciary standard for brokers and advisors, which would be the best way to give investors confidence that their interests come first. But you didn't.

And that's not the only part of Dodd-Frank you are working to undermine. Look at the SEC's proposal to amend the whistleblower program, which is one of the most successful programs created under Dodd-Frank. We need brave workers to stand up to corruption and abuse when they see financial companies scamming people or engaging in other illegal behavior.

The only way individual workers are ever going to able to stand up to powerful Wall Street firms is if we give them protection.

We've already seen a chilling effect from your proposal.

Each year since inception of the program, the number of tips has increased, in some years by more than 10 percent. But after your rule proposal in 2018 introduced a cap on whistleblower awards, the number of tips declined for the first time in 2019.

The proposed cap on awards raised so many alarm bells that you had to put out a statement to clarify. I know "whistleblower" is a dirty word nowadays to some in this town. It always is to serial lawbreakers.

I don't see how you can make significant changes to a successful program like this without understanding that the decline in tips is a result of your actions, and the environment this Administration has created, attacking rather than protecting those who speak out against abuse of power.

As the SEC continues to take fewer actions that hold the largest financial institutions accountable, we must encourage whistleblowers to identify misconduct wherever it exists and help uncover complex frauds.

The SEC's recent proposed rules on proxy advisors and shareholder proposals are also clear examples of the Administration taking the side of corporate interests over Americans saving and investing for their future.

Both proposals make it more difficult for shareholders to hold corporate executives accountable.

The proposal on proxy advisors could make it harder for institutional investors to have timely access to independent research and analysis from the proxy advisory firms that they hire. The proposed rule would give corporations access to investors' research before the public retirement systems, investment fund managers, and foundations who manage hardworking Americans' money.

The SEC says the changes are necessary because of errors and inaccuracies, but it provided scant evidence of errors. Instead, the new rule would give companies a new tool to intimidate proxy advisers and threaten their independence.

The overhaul of the shareholder proposal rule would make it easier for corporate management to silence shareholders and avoid dealing with important issues critical to investors.

The amendments could stop proposals for votes on issues such as disclosure of corporate political spending, separating the roles of Board Chair and CEO, and nondiscrimination policies.

I am disappointed in the direction you've taken these rules that have for decades allowed investors to hold management accountable, all while executives are further entrenching themselves and ignoring workers and shareholders.

Protecting workers' hard-earned savings should begin with a simple concept: putting their rights first.

Mr. Chair, I hope that the SEC will remember that.

But over the last week we have had nearly all the financial regulators before the Committee—the Fed, the FDIC, the NCUA, and today the SEC—all defending the same policies that amount to a wish list for Wall Street and corporate interests. The President promised to look out for ordinary, hardworking people, but he and the people he has put in charge of these agencies betray those workers over and over and over.

Mr. Chairman, I'd like to offer for the record this letter from the Ohio Public Employees Retirement System, raising concerns about the SEC's rulemaking on proxy advisory firms.

Thank you, Chairman Crapo.

**Testimony on "Oversight of the Securities and Exchange Commission"**

**Before the**
**U.S. Senate Committee on Banking, Housing, and Urban Affairs**

**Jay Clayton**
**Chairman, U.S. Securities and Exchange Commission**
**December 10, 2019**

Chairman Crapo, Ranking Member Brown and Senators of the Committee, thank you for the opportunity to testify before you today about the work of the U.S. Securities and Exchange Commission (SEC or Commission or agency).[1] I am honored to discuss the great work of the women and men of the SEC over the past year in furtherance of our tripartite mission of protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation.

Chairing the Commission is a great privilege, and I am fortunate to be able to observe firsthand the incredible work done by the agency's almost 4,400 dedicated staff in Washington, DC and across our eleven regional offices. Our people are our greatest asset and are often our most direct connection to investors and other market participants. None of the work described in this testimony—which is only a small sample of the overall work of the staff over the past year—is possible without these dedicated and experienced professionals. In turn, our public-facing work is made possible thanks to the important, often behind-the-scenes work of the agency's administrative and operations personnel. In short, the women and men of the SEC bring a mission-focused, team-oriented perspective to our work every day, always keeping the long-term interests of our Main Street investors front of mind.

I am proud of our accomplishments over the past year and look forward to building on this work as we continually review and recalibrate our efforts. America's historical approach to our capital markets—an approach focused on transparency, materiality, fairness and accountability—has produced a remarkably deep pool of capital with unprecedented participation. It is our Main Street investors and their willingness to entrust their hard-earned money to our capital markets for the long term that have provided the seeds for the deepest, most dynamic and most liquid capital markets in the world. Their capital provides businesses and municipalities with the opportunity to invest, grow and create jobs with an organic dynamism that stands apart both today and since the Commission was formed 85 years ago. In turn, our markets have provided American Main Street investors with better domestic and international investment opportunities than comparable investors in other jurisdictions.

We are dedicated to preserving, expanding and improving this far-reaching and extremely beneficial economic and social dynamic.

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[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 or any Commissioner.

**Strategic Plan**

Last fall, the Commission released its Strategic Plan for 2018-2022. The Plan provides a forward-looking framework for making the SEC more effective, focusing on the most important goals and initiatives that will best position the SEC to fulfill its mission, with the primary focus of the Plan being on investors, innovation and improved performance.[2] Over the past year, we have made meaningful progress toward achieving these goals.

Our first goal is to focus on the long-term interests of Main Street investors. This year we have continued to place a high priority on direct engagement with investors and other market participants. Staff across our divisions and offices traveled around the country to attend events both to educate investors and to listen to the challenges they have experienced first-hand in our markets. It is invaluable for us to hear from them, in their own words, how our capital markets are working for them and what more can be done.

Our second goal is to be responsive and innovative in the face of significant market developments and trends. As technological advancements and commercial developments have changed how our securities markets operate, the SEC's ability to remain an effective regulator requires that we continuously monitor the market environment and, as appropriate, adjust and modernize our expertise, rules, regulations and oversight tools and activities. The Commission advanced this goal on several fronts, including through the work across our divisions and offices to modernize our regulatory framework, as well as the Commission's forward-thinking approach to an increasingly technological and data-driven landscape through the work of the Division of Enforcement's (Enforcement) Cyber Unit and the new Strategic Hub for Innovation and Financial Technology (FinHub).

Our third goal—elevating the agency's performance through technology, data analytics and human capital—embodies our commitment to maintaining an effective and efficient operation in our ever-evolving capital markets ecosystem. Maintaining a high level of staff engagement, performance and morale is critical to our ability to execute the SEC's mission. We deeply appreciate the resources Congress has provided, and in fiscal year (FY) 2019, the funding Congress provided allowed us to lift our hiring freeze and make new hires in critical areas—including enforcement and examinations, market oversight, cybersecurity, and small business capital formation. I am pleased to report that we have filled approximately 140 new positions (over 90 percent of our target) with high-quality individuals who have the experience and expertise necessary to enhance our market oversight and improve our ability to serve American investors.

One of the most important ways we can continually improve the SEC's operational effectiveness is by investing in our technology program, including improving our data analysis and promoting information sharing and collaboration across the agency. In addition, focusing on cybersecurity remains a top priority for the agency. The resources Congress has provided has 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

[2] *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.

to modernize legacy systems and infrastructure and reduce our risk profile. We also will continue to work to better streamline and automate our business processes so we can conduct our work more efficiently in support of the SEC's mission.

**FY 2019 Initiatives and Upcoming Policy Agenda**

As I have previously testified, 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.

In 2018, the Commission advanced 23 of the 26 rules in the near-term agenda, a good result on both a percentage basis (88 percent) and an absolute basis.[3] For 2019, the number of items on our near-term agenda increased to a seemingly aspirational 39.[4] As of the date of this testimony, the Commission has advanced 34 of those 39 rulemakings, or 87 percent of the items—even though our rulemaking efforts were stalled for more than a month as a result of the lapse in appropriations earlier this year.[5] In addition, the Commission advanced several rulemakings more quickly than expected.

Of course, we must be judged on the impact of our efforts and not the number of rules proposed and adopted. In evaluating that impact, we ask whether our efforts meaningfully advance the Commission's tripartite mission, and importantly, whether our actions further the interests of our long-term Main Street investors. I believe modernization is a particularly effective means to advance each component of our mission simultaneously. We have approached modernization by: (1) identifying aspects of our regulatory framework that are out of step with our ever-changing capital markets ecosystem; and (2) bringing those aspects back into line with market realities in a way that advances all aspects of our mission. With that perspective in mind—a perspective that moves beyond the static and often stale claims that advancing one aspect of our mission (e.g., investor protection) must come at a cost to another (e.g., capital formation)—I will highlight some of the Commission's major accomplishments in 2019.

***Standards of Conduct for Investment Professionals***

In June 2019, the Commission adopted a package of rulemakings and interpretations designed to enhance the quality and transparency of retail investors' relationships with

[3] *See* Testimony on Oversight of the U.S. Securities and Exchange Commission (Dec. 11, 2018), *available at* https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0.
[4] *See* Appendix A. As I have previously remarked, in the earlier parts of the decade—known in the financial regulatory community as the "post Dodd-Frank era"—the Commission's near-term portion of the "Reg Flex" agenda has become too aspirational. On average over that period, only about one-third of the rules listed in the Commission's agenda to be adopted in the following 12 months were timely completed.
[5] *See* Appendix A. Of those 39 rulemakings, 18 were scheduled for adoption by this year, and as of today, we have completed 16 of the 18, or 89 percent.

investment advisers and broker-dealers and bring the standards of conduct and required disclosures of financial professionals in line with what a reasonable investor would expect while preserving access—in terms of choice and cost—to a variety of investment services and products. Said simply—from discount brokerage, to internet advisers, to full-service commission brokerage, to a wrap-fee combination of advisory and brokerage—(1) financial professionals cannot put their interests ahead of their client's or customer's interests; and (2) financial professionals must tell their clients and customers, in plain language, the scope of the services they provide and how they make money providing those services.

Our final rulemaking package was the result of an organic, staff-driven process, drawing on the decades of experience and expertise of our staff as well as input from an array of market participants—including from seven investor town halls around the country where, in an unscripted, take-any-questions environment, we heard directly from investors. We are continuing this direct Main Street investor engagement, as discussed in more detail below. This rulemaking package also benefitted significantly from thousands of unique comment letters and the results of substantial investor testing. I am extremely grateful to our staff for bringing long overdue regulatory rationality and clarity to this important market, which encompasses some 43 million American households.

Specifically, these actions include new Regulation Best Interest, the new Form CRS Relationship Summary (Form CRS) and two separate interpretations under the Investment Advisers Act of 1940 (Advisers Act).[6] Individually and collectively, these actions will enhance and clarify the standards of conduct applicable to broker-dealers and investment advisers, help retail investors better understand and compare the services offered and make an informed choice of the relationship best suited to their needs and circumstances and foster greater consistency in the level of protections provided by each regime, particularly at the point in time that a recommendation is made by a broker-dealer or advice is provided by an investment adviser.

Under Regulation Best Interest, broker-dealers are required to act in the best interest of a retail customer when making a recommendation of any securities transaction or investment strategy involving securities to a retail customer. This obligation includes account recommendations such as whether to roll an employer-sponsored 401(k) account into an IRA. Regulation Best Interest enhances the broker-dealer standard of conduct beyond existing suitability obligations and makes it clear that a broker-dealer may not put its financial interests ahead of the interests of a retail customer when making recommendations. In order to comply with Regulation Best Interest, broker-dealers must satisfy four specified component obligations—Disclosure, Care, Conflict of Interest and Compliance—each of which includes a number of prescriptive requirements, all of which must be satisfied to comply with the rule.

Form CRS will require investment advisers and broker-dealers to provide retail investors with streamlined information to aid them in understanding the nature of their relationship with their financial professional. Firms will be required to provide information about their relationship and services, fees and costs, conflicts of interest, standard of conduct and legal or

[6] *See* Press Release 2019-89, SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships with Financial Professionals (June 5, 2019), *available at* https://www.sec.gov/news/press-release/2019-89.

disciplinary history of the firm and its financial professionals, in additional to other information. This disclosure will have a standardized question-and-answer format to promote comparability across firms. Additionally, Form CRS will include a link to a dedicated page on the Commission's investor education website, Investor.gov, which offers educational information about broker-dealers and investment advisers, and other retail investor-oriented materials.

The Commission also issued an interpretation to reaffirm—and in some cases clarify—certain aspects of the federal fiduciary duty that an investment adviser owes to its clients, confirming the Commission's longstanding view that an investment adviser must, at all times, serve the best interest of its clients and not subordinate its client's interest to its own. This interpretation underscores the core duties of care and loyalty that advisers have as fiduciaries and provides examples intended to help advisers better understand how those duties apply in practice. Additionally, the Commission issued an interpretation of the "solely incidental" prong of the broker-dealer exclusion under the Advisers Act, which confirms and clarifies the Commission's position and provides guidance on the application of the interpretation to exercising investment discretion over customer accounts and account monitoring.

In connection with this rulemaking, the Commission launched a Main Street investor education campaign designed to help retail investors understand key differences between broker-dealers and investment advisers and help them decide whether working with one of these types of financial professionals is right for them. Features of this campaign include short, educational videos designed to provide ordinary investors with basic information about investment professionals available on Investor.gov,[7] in addition to a series of retail investor events.[8]

Recognizing that these new rules may require various market participants to make changes to their operations, including to their mandatory disclosures, marketing materials and compliance systems, the Commission established an inter-divisional Standards of Conduct Implementation Committee who are meeting regularly to assist market participants with their implementation efforts. Market participants are actively engaging with staff in planning for implementation and compliance, and our staff has already issued several responses to frequently asked questions.[9] I encourage the public to continue this engagement by sending questions to IABDQuestions@sec.gov. We recognize that there is more work to be done and we are committed to continued engagement with investors and other market participants.

***Improving the Proxy Process***

Improving the transparency, accountability and functionality of the proxy process is another significant Commission initiative designed to serve the interests of our long-term Main Street investors. In the past two decades, the proxy process has become one of both (1) increased complexity and (2) importance to investors, issuers and investment advisers.

[7] *See* Press Release 2019-153, SEC Releases Videos for Investors Choosing and Working with a Financial Professional (Aug. 15, 2019), *available at* https://www.sec.gov/news/press-release/2019-153.
[8] *See* Press Release 2019-144, SEC Chairman Clayton Announces Event for Main Street Investors in Chicago (Aug. 5, 2019), *available at* https://www.sec.gov/news/press-release/2019-144; Press Release 2019-100, SEC Chairman Clayton Announces Events for Main Street Investors in Boston (June 19, 2019), *available at* https://www.sec.gov/news/press-release/2019-100.
[9] *See* Frequently Asked Questions on Form CRS, *available at* https://www.sec.gov/investment/form-crs-faq.

Commission rule changes, state law changes, corporate governance practices, technology and other factors have all increased the interest in, and significance of, shareholder engagement and shareholder voting in our public capital markets. During this time, investment advisers have also assumed a much greater role in our marketplace and, consequently, a greater role in the area of beneficial owner- shareholder-company engagement.[10] Last fall, the Commission held a roundtable on improving the proxy process that brought together investors, issuers and other market participants who raised and discussed many issues in this area.[11] We have also received significant public comment and helpful suggestions to improve our proxy voting system.[12] While there are a wide range of viewpoints on these topics, one thing is clear—there is significant interest in modernizing and improving the proxy process. The Commission has taken a number of concrete steps during this year to increase transparency, accountability and functionality in the area of proxy voting.

Building on decades of experience and extensive engagement, in August 2019, the Commission took an important first step in strengthening the integrity of the proxy voting process.[13] Specifically, the Commission issued guidance to assist investment advisers in establishing and fulfilling their proxy voting responsibilities. Voting is a key component of shareholder engagement and investing generally. Investment advisers are fiduciaries and owe each of their clients duties of care and loyalty with respect to actions taken on the clients' behalf, including proxy voting. The guidance clarifies how an investment adviser's fiduciary duty and Rule 206(4)-6 under the Advisers Act relate to an adviser's proxy voting on behalf of clients, including if the investment adviser retains a proxy voting advice business. On the same date, the Commission issued an interpretation that proxy voting advice provided by proxy voting advice businesses generally constitutes a "solicitation" under the federal proxy rules and provided related guidance about the application of the proxy antifraud rule to proxy voting advice.

Last month, the Commission continued its efforts to improve the proxy voting system by proposing amendments to the rules governing proxy solicitations to help ensure that investors who use proxy voting advice businesses receive accurate, transparent and complete information on which to base their voting decisions.[14] The proposed amendments would, among other things, enhance the quality of the disclosure about material conflicts of interests that proxy voting advice businesses provide their clients. The proposal would also provide registrants and other soliciting persons an opportunity to review and provide feedback on proxy voting advice before it is issued. Importantly, though, the proposed process would leave the content of the proxy voting advice entirely within the discretion of the proxy voting advice business, which will be under no obligation to make any revisions to the proxy voting advice simply because an issuer provides comments on the advice. Additionally, the proposal would not create a new liability regime for proxy voting advice businesses.

[10] For example, there are now over 13,000 SEC-registered investment advisers with over $84 trillion in assets under management, and over 8,000 of these investment advisers provide services to retail investors.
[11] *See* Spotlight on the Proxy Process, *available at* https://www.sec.gov/proxy-roundtable-2018.
[12] *See* Comments on Statement Announcing SEC Staff Roundtable on the Proxy Process, *available at* https://www.sec.gov/comments/4-725/4-725.htm.
[13] *See* Press Release 2019-158, SEC Clarifies Investment Advisers' Proxy Voting Responsibilities and Application of Proxy Rules to Voting Advice (Aug. 21, 2019), *available at* https://www.sec.gov/news/press-release/2019-158.
[14] *See* Press Release 2019-231, SEC Proposes Rule Amendments to Improve Accuracy and Transparency of Proxy Voting Advice (Nov. 5, 2019), *available at* https://www.sec.gov/news/press-release/2019-231.

On the same date, the Commission also proposed amendments to modernize the rule that governs the process for shareholder proposals to be included in the company's proxy statement.[15] The proposed amendments would replace the current ownership requirements with a tiered approach that would provide three options for demonstrating an ownership stake through a combination of the amount of securities owned and length of time held. The proposal maintains the long-standing $2,000 minimum ownership threshold for shareholders provided they have owned their shares for three or more years. The proposed amendments also would amend the current resubmission thresholds of 3, 6, and 10 percent—which have not been updated since 1954—to 5, 15, and 25 percent, respectively, and allow companies to exclude shareholder proposals under certain circumstances where shareholder support for the matter has declined. Said another way, if a shareholder cannot get more than 1 in 20—or 5 percent—of its fellow shareholders to support its proposal in the first year, or more than 1 in 4 shareholders after three years of proxy inclusion within a five-year period, that shareholder proposal would be subject to a limited, company-specific time out under the proposed rules.[16]

Our proposals are based on fundamental tenets of our federal securities laws, including providing investors with information that is accurate, not misleading and decision useful.[17] Commission attention, as well as increased transparency and accountability, are long overdue. We welcome additional input on these matters, including suggestions for improving our proposals. More generally, I expect our work to modernize and improve the proxy process to continue.[18]

***Facilitating Capital Formation in our Public Markets***

Led by the Division of Corporation Finance (Corporation Finance), the SEC took meaningful steps during FY 2019 to increase the attractiveness of the public markets while maintaining—and in many cases, enhancing—investor protections. Encouraging capital formation in our public markets has the benefit of providing a broader and more attractive set of investment opportunities to Main Street investors, who benefit from public company stock prices that reflect not only publicly reported information but also the views of professional investors. Additionally, it is my experience, and the view of our Director of Corporation Finance, that companies that go through the SEC public registration and offering process often come out as better companies, providing meaningful benefits to the company, investors and our capital markets.

*Expanding JOBS Act Benefits*. In 2012, Congress passed the Jumpstart Our Business Startups (JOBS) Act with strong bipartisan support. To encourage more companies to enter our

[15] *See* Press Release 2019-232, SEC Proposes Amendments to Modernize Shareholder Proposal Rule (Nov. 5, 2019), *available at* https://www.sec.gov/news/press-release/2019-232.
[16] Please note that this "time out" does not mean that the shareholder proposal cannot come up again in the future or be submitted to a different company.
[17] *See* TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) ("An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.).
[18] *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. [hereinafter Fall 2019 Regulatory Flexibility Agenda].

public markets, the JOBS Act provided a new category of companies—emerging growth companies—with a number of accommodations. Since the early 2000s there has been a dramatic shift from companies raising growth capital in our public equity markets to raising growth capital in our private capital markets.[19] Main Street investors have very limited access to our private capital markets and, where they do have access, unlike our public capital markets, they often do not sit side-by-side with institutional investors. The JOBS Act was instrumental in slowing down this shift from public markets to private markets. Building on principles underpinning the JOBS Act, over the past two years, the SEC has expanded several of these accommodations to encourage more companies to consider entering the public capital markets without diminishing important investor protections.

This past year, the SEC continued its efforts to increase the attractiveness of the public markets.[20] For example, in September 2019, the Commission expanded a key initiative from the JOBS Act when it adopted a final rule to extend the "test-the-waters" accommodation to all issuers—not just emerging growth companies—allowing them to gauge market interest in a possible initial public offering (IPO) or other proposed registered securities offering by permitting discussions with certain investors prior to the filing of a registration statement. I have seen firsthand how this has benefitted emerging growth companies considering an IPO, as they are able to engage investors earlier to explain their business and obtain feedback in advance of a public offering. Investors and shareholders also benefit, as companies can better determine the appropriate time for an offering, identify information that is important to investors and size and price the offering more effectively.

Continuing to build on the principles of the JOBS Act, the Commission has also taken important steps to permit scaled disclosures for small and medium-sized companies, while maintaining important investor protections. Recognizing that one size does not fit all for the regulation of public companies, in May 2019, the Commission proposed amendments to more appropriately tailor the "accelerated filer" and "large accelerated filer" definitions.[21] Under the proposed amendments, smaller reporting companies with less than $100 million in revenues would not be required to obtain an attestation of their internal control over financial reporting

[19] Based on an analysis by staff in the Commission's Division of Economic and Risk Analysis, in 2018, registered offerings accounted for $1.4 trillion of new capital compared to approximately $2.9 trillion that the staff estimates was raised through exempt offering channels. Today: (1) we have roughly half the number of public companies we had twenty years ago; (2) growing companies are staying private substantially longer; and (3) public equity markets are being used more for liquidity by venture capital and private equity investors than for accessing new growth capital. *See* Remarks to the Economic Club of New York (Sept. 9, 2019), *available at* https://www.sec.gov/news/speech/speech-clayton-2019-09-09#_ftnref9.

[20] In July 2017, Corporation Finance expanded the draft registration statement submission process to all first-time registrants and newly public companies conducting initial IPOs and offerings within one year of an IPO. These changes were intended to encourage IPOs generally and earlier in the life cycle of growing companies and to give all companies—not just emerging growth companies—more control over their offering schedules, which limits their exposure to market volatility and competitive harm—providing a benefit to their shareholders without diminishing investor protection. Under the new policy, Corporation Finance has received draft submissions for more than 80 IPOs and for more than 175 offerings within one year of an IPO. *See also* Press Release 2018-297, SEC Adopts Final Rules to Allow Exchange Act Reporting Companies to Use Regulation A (Dec. 19, 2018), *available at* https://www.sec.gov/news/press-release/2018-297.

[21] *See* Press Release 2019-68, SEC proposes Amendments to More Appropriately Tailor the Accelerated and Large Accelerated Filer Definitions (May 9, 2019), *available at* https://www.sec.gov/news/press-release/2019-68.

from an independent outside auditor. For many smaller companies that received a similar five-year exemption under the JOBS Act, this proposal would extend that exemption until the company exceeded $100 million in revenues. The Commission is not considering any changes to the Sarbanes-Oxley requirements that apply to smaller reporting companies with respect to independent audit committees, CEO and CFO certifications of financial reporting, or the requirement that they continue to establish, maintain, and assess the effectiveness of their internal control over financial reporting.

*Modernizing Disclosure Requirements; Human Capital Disclosure.* The Commission has also taken a number of actions to simplify and update disclosure requirements in an effort to enhance the quality of information available to investors and reduce costs for registrants.[22] For example, in March 2019, the Commission adopted amendments to modernize and simplify disclosure requirements under Regulation S-K for public companies, investment advisers and investment companies, consistent with its mandate under the Fixing America's Surface Transportation (FAST) Act.[23] In August 2019, the Commission proposed additional amendments to modernize the description of business, legal proceedings and risk factor disclosures that registrants are required to make pursuant to Regulation S-K.[24] The proposal to modernize these core disclosure requirements, among other things, recognizes the significant changes that have taken place in our economy in the last thirty years, including that, in certain industries, intangible assets, and in particular human capital, often are a significant driver of long-term value in today's global economy.

Here, I offer a personal observation. I have had the privilege of being exposed to a wide variety of domestic and international companies over the past 25 years. In my experience, many of the companies that have performed well over time have focused on monitoring and improving their human capital. These companies have approached human capital management in a wide variety of ways, reflecting the characteristics of their industries, markets and size and other largely company-specific, sector-specific and geographic-specific factors. In addition, as the domestic and global economies have evolved, the importance of human capital to performance and, accordingly, investor decision making in higher growth sectors appears to have increased. I believe investors benefit from understanding the various ways registrants monitor and enhance their human capital and welcome comments on our proposal.

We expect efforts to modernize, improve and simplify disclosure requirements to continue in the coming year.[25] I believe these measures have the potential to save issuers

[22] *See, e.g.*, Press Release 2019-179, SEC Proposes Rules to Update Statistical Disclosures for Banking Registrants (Sept. 17, 2019), *available at* https://www.sec.gov/news/press-release/2019-179; Press Release 2019-65, SEC Proposes to Improve Disclosures Relating to Acquisitions and Dispositions of Businesses (May 3, 2019), *available at* https://www.sec.gov/news/press-release/2019-65.

[23] *See* Press Release 2019-38, SEC Adopts Rules to Implement FAST Act Mandate to Modernize and Simplify Disclosure (Mar. 20, 2019), *available at* https://www.sec.gov/news/press-release/2019-38.

[24] *See* Press Release 2019-148, SEC Proposes to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K (Aug. 8, 2019), *available at* https://www.sec.gov/news/press-release/2019-148.

[25] In the coming year, I expect the Commission will consider final amendments to simplify and streamline certain financial disclosure requirements for guaranteed debt offerings and significant acquisitions and dispositions. Additionally, SEC staff is developing proposals to modernize and streamline disclosures provided to investors, including MD&A, Selected Financial Data and Supplementary Financial Information. *See* Fall 2019 Regulatory Flexibility Agenda, *supra* note 18.

significant time and expense, enhance the quality of disclosure and increase investor protection. While some of these rule changes may appear technical, I anticipate that, collectively, they will yield substantial benefits for public companies and investors, both in themselves and when taken together with other capital formation initiatives at the Commission.

Long-Term Performance and Quarterly Reporting. Another important issue under consideration is how to foster (or not undermine) a longer-term performance perspective in companies, including for the benefit of long-term Main Street investors. These important investors are increasingly responsible for funding their own retirement and other financial needs, and we should be examining both whether the companies they invest in have a similar perspective on their performance horizon and whether our regulations are inappropriately or unnecessarily affecting that perspective. In December 2018, the Commission published a request for comment soliciting input on the nature, content and timing of earnings releases and quarterly reports made by reporting companies and specifically asked for comments on whether and how our reporting system may be causing companies to focus their time and resources disproportionally on short-term results.[26] In July 2019, the SEC staff held a roundtable to hear from investors, issuers and other market participants on these issues.[27] I was pleased with the diverse views and ideas shared on market-based initiatives and regulatory changes that could foster a longer-term performance perspective in companies for the benefit of America's Main Street investors.

***Private Offering Harmonization and Small Business Capital Formation***

The Commission has also been focused in FY 2019 on initiatives to facilitate access to capital for smaller issuers before they enter the public markets. We also are committed to ensuring that our Main Street investors continue to have the best possible mix of investment opportunities. These are related issues. In June 2019, the Commission issued a concept release that seeks comment on possible ways to simplify, harmonize and improve the exempt offering framework to expand investment opportunities and promote capital formation while maintaining appropriate investor protections.[28] While Congress and the SEC have taken a number of steps to expand the options for small businesses to raise capital—most notably in the JOBS Act and related rules—these changes have been introduced over time, leading to a patchwork of rules and exemptions. There has not been a comprehensive review of our exempt offering framework to ensure that the system, as a whole, is rational, accessible and effective. The concept release brings these topics to the forefront.

Our private markets have become increasingly important and are now often seen as more attractive for companies and professional investors than our public markets, in terms of amounts of capital raised, investment opportunities and returns, among other metrics. However, the private market regulatory framework—one that is heavily reliant on our wealth-based definition

[26] *See* Press Release 2018-287, SEC Solicits Public Comment on Earnings Releases and Quarterly Reports (Dec. 18, 2018), *available at* https://www.sec.gov/news/press-release/2018-287.
[27] *See* Press Release 2019-117, SEC Staff to Host July 18 Roundtable on Short-Term/Long-Term Management of Public Companies, our Periodic Reporting System and Regulatory Requirements (July 2, 2019), *available at* https://www.sec.gov/news/press-release/2019-117.
[28] *See* Press Release 2019-97, SEC Seeks Public Comment on Ways to Harmonize Private Securities Offering Exemptions (June 18, 2019), *available at* https://www.sec.gov/news/press-release/2019-97.

of "accredited investor"—is rooted in the markets, technology and employment and professional relationships that existed thirty or more years ago. As a result, access to potentially attractive investment opportunities for Main Street investors who do not meet those wealth standards is limited and, where it is available, costly. Additionally, the private offering framework often does not function well for small and medium-sized companies seeking to grow beyond the start-up stage, particularly those that do not have established relationships with professional investors.

I expect the Commission to consider staff recommendations to amend the accredited investor definition in the near future, including whether the definition should include non-wealth-based ways for individuals to qualify, and more broadly, whether the limitations on who can invest in certain exempt offerings provide an appropriate level of investor protection or pose an undue obstacle to capital formation or investor access to investment opportunities. Additionally, I believe it is our obligation to explore whether we can increase opportunities for Main Street investors in the private markets while maintaining strong and appropriate investor protections. To that end, staff is examining whether appropriately structured funds can facilitate Main Street investor access to private investments.[29] I believe it is important to focus on solutions that provide access to investment opportunities on substantially the same terms as those that would be available to institutional investors.

In addition, I expect the Commission will consider a proposal to modernize rules relating to the exemption that permits private companies to issue securities as compensation to employees, consultants and advisors, building upon our amendments to the rule as required by the Economic Growth, Regulatory Relief, and Consumer Protection Act.[30] The so-called "gig economy" has changed how companies and individuals design alternative work arrangements, and we should ensure our regulatory framework reflects changes in our marketplace, including our labor markets.

***Modernizing Asset Management Regulations***

ETF Regulatory Framework. Another important modernization initiative the Commission completed this year concerns exchange-traded funds (ETFs). Since 1992, the Commission has issued more than 300 individualized, exemptive orders allowing ETFs to operate under the Investment Company Act. During that same period, ETFs have grown substantially; today there are approximately 2,000 ETFs with over $3.7 trillion in total net assets. As the ETF industry continues to grow in size and importance, particularly to Main Street investors, it is important to have a consistent, transparent and efficient regulatory framework that eliminates regulatory hurdles while maintaining appropriate investor protections. To that end, in September 2019, the Commission adopted a new rule and form amendments designed to modernize the regulation of ETFs by establishing a clear and consistent framework for the vast majority of ETFs operating today.[31] In my view, this action will facilitate greater competition

[29] *See* Remarks at Meeting of the SEC's Small Business Capital Formation Advisory Committee (Nov. 12, 2019), *available at* https://www.sec.gov/news/public-statement/clayton-remarks-small-business-capital-formation-advisory-committee-111219.
[30] *See* Fall 2019 Regulatory Flexibility Agenda, *supra* note 18.
[31] *See* Press Release 2019-190, SEC Adopts New Rule to Modernize Regulation of Exchange-Traded Funds (Sept. 26, 2019), *available at* https://www.sec.gov/news/press-release/2019-190.

and innovation in the ETF marketplace and will allow ETFs meeting certain standardized conditions to come to market more quickly without the time or expense of applying for individual exemptive relief, leading to more choice for investors.

As the Commission modernizes the regulatory framework for ETFs with the new rule and related amendments for more standardized ETFs, opportunities to consider novel ETFs and other products or innovations in fund operations remain. Product innovations often depend on the flexibility of the Investment Company Act to accommodate new ideas and choice while preserving investor protections. For example, the Commission has recently approved, and issued notices of intent to approve, several novel types of actively-managed ETFs.[32] In addition, in October 2019, the Commission proposed amendments to modernize the exemptive relief process and make it more efficient and transparent.[33] The proposed changes are intended to grant relief as efficiently and quickly as possible, while ensuring that applications continue to be carefully analyzed consistent with the relevant statutory standards. A more efficient application process would allow applicants to realize the benefits of relief more quickly, making the application process less expensive and would allow the Commission to devote resources to the review of more novel requests. In my view, these amendments will provide important benefits to funds and their shareholders, foster financial innovation and increase the diversity of opportunities for investors, all while maintaining important safeguards of the Investment Company Act.

*Investment Adviser Advertising and Solicitations.* Consistent with our focus on modernization, in November 2019, the Commission proposed amendments to the rules governing investment adviser advertisements and payments to solicitors to reflect changes in technology, investor expectations and the evolution of industry practice.[34] These rules provide important protections when advisers seek to attract clients and investors, yet they have not been updated in a comprehensive way since their adoption in 1961 and 1979, respectively. Meanwhile, our markets, technology and the information investors want—both in form and in content—have evolved significantly. The proposed amendments would replace the current advertising rule's broadly drawn limitations with principles-based provisions and expand the solicitation rule to cover arrangements involving all forms of compensation, rather than only cash, subject to a new de minimis threshold. These proposals are designed to address market developments and improve the quality of information available to investors, enabling them to make more informed choices. In connection with the proposed amendments, the Commission is specifically seeking feedback from investors and smaller advisers through the use of two short-form feedback flyers.

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[32] *See* T. Rowe Price Associates, Inc. and T. Rowe Price Equity Series, Inc., Investment Company Act Release No. 33685 (Nov. 14, 2019), *available at* https://www.sec.gov/rules/ic/2019/ic-33685.pdf; Natixis ETF Trust II, et al., Investment Company Act Release No. 33684 (Nov. 14, 2019), *available at* https://www.sec.gov/rules/ic/2019/ic-33684.pdf; Fidelity Beach Street Trust, et al., Investment Company Act Release No. 33683 (Nov. 19, 2019), available at https://www.sec.gov/rules/ic/2019/ic-33683.pdf; Blue Tractor ETF Trust and Blue Tractor Group, LLC, Investment Company Act Release No. 33682 (Nov. 14, 2019), *available at* https://www.sec.gov/rules/ic/2019/ic-33682.pdf; Precidian ETFs Trust, et al., Investment Company Act Release No. 33477 (May 20, 2019), *available at* https://www.sec.gov/rules/ic/2019/ic-33477.pdf.

[33] *See* Press Release 2019-219, SEC Proposed Amendments to Exemptive Applications Procedures (Oct. 18, 2019), *available at* https://www.sec.gov/news/press-release/2019-219.

[34] *See* Press Release 2019-230, SEC Proposes to Modernize the Advertising and Cash Solicitation Rules for Investment Advisers (Nov. 4, 2019), *available at* https://www.sec.gov/news/press-release/2019-230.

*Use of Derivatives by Mutual Funds, ETFs, Closed-End Funds and BDCs.* Today, funds follow a broad variety of investment strategies and provide diverse investment opportunities for fund investors. As funds' strategies have become increasingly diverse, funds' use of derivatives has grown in both volume and complexity over the past several decades. The existence, use, benefits and risks of these products were not contemplated when the Investment Company Act was enacted. Over the past several decades, extensive changes that have taken place in our capital markets and the fund industry, including the importance of derivatives in effective portfolio management.

Last month, the Commission proposed a new rule designed to enhance the regulation of the use of derivatives by registered investment companies, including mutual funds, ETFs and closed-end funds, as well as business development companies. The proposed rule would provide an updated and more comprehensive approach to the regulation of funds' derivatives use.[35] Under the proposed rule, funds would be permitted to enter into derivatives transactions and certain other transactions, notwithstanding the restrictions on indebtedness under the Investment Company Act, provided that the funds comply with certain conditions designed to protect investors. These include adopting a derivatives risk management program and complying with a limit on the amount of leverage-related risk that the fund may obtain (based on value-at-risk). The proposed rule would include a streamlined set of requirements for funds that use derivatives in a limited way. Certain registered investment companies that seek to provide leveraged or inverse exposure to an underlying index—including leveraged ETFs—would not be subject to the proposed limit on fund leverage risk but instead would be subject to alternative requirements under the Commission's proposal, which includes limiting the investment results to 300 percent of the return (or inverse of the return) of the underlying index. Additionally, purchases and sales of these funds would be subject to new sales practice rules. By standardizing the framework for funds' derivatives risk management, the proposal would benefit investors, funds and our markets, including by providing for more-effective risk management across funds and enhanced investor protections.

*Modernizing Fund Disclosures and BDC Offering Reform.* The Division of Investment Management (Investment Management) is leading a long-term project to explore modernization of the design, delivery and content of fund disclosures and other information for the benefit of investors. These initiatives are an important part of how the Commission can serve investors in the 21st century. Fund disclosures are especially important because millions of Americans invest in funds to help them achieve personal financial goals, such as saving for retirement and their children's educations. As of the end of 2018, over 100 million individuals representing nearly 57 million households, or 45 percent of U.S. households, owned funds (generally ETFs or mutual funds).[36]

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[35] *See* Press Release 2019-242, SEC Proposes to Modernize Regulation of the Use of Derivatives by Registered Funds and Business Development Companies (Nov. 25, 2019), *available at* https://www.sec.gov/news/press-release/2019-242.

[36] *See* Investment Company Institute, 2019 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry, 2, 59th ed. 2019.

In June 2018, the Commission issued a request for comment on how to improve fund disclosures for the benefit of Main Street investors.[37] Based on the feedback received from investors regarding the length and complexity of fund disclosures, the staff in Investment Management is considering recommendations to the Commission to improve shareholder reports and the disclosure of fund fees, including options for a shorter and more engaging report that gives shareholders key information to assess and monitor their fund investments. Related to the fund disclosure modernization initiative, in October 2018, the Commission proposed a "summary prospectus" designed to improve disclosure for investors about variable annuity and variable life insurance contracts.[38] The proposal, which mirrors the layered disclosure approach for mutual funds, is another important step in the Commission's efforts to provide Main Street investors with better information to make informed investment decisions.

Additionally, consistent with congressional mandates under the Small Business Credit Availability Act and the Economic Growth, Regulatory Relief, and Consumer Protection Act, this year, the Commission proposed rule and form amendments to modernize the offerings of BDCs and registered closed-end funds.[39] Specifically, the proposed amendments would modify the registration, communications and offering processes available to BDCs and registered closed-end funds, building on offering practices that operating companies currently use. I expect the Commission to consider final rule recommendations in the coming year.[40]

***Modernizing Trading and Market Structure***

Technology-Driven Changes in Market Structure. One of our key responsibilities as regulators is to strive to ensure that as technology changes, our regulations continue to drive efficiency, integrity and resilience. As technology and business practices evolve, so must our regulatory framework. This is irrefutably true for the regulation of our U.S. equity markets, which have undergone an almost unimaginable transformation in the last decade, largely driven by the deployment of a vast array of advanced communications and data analytics technologies. To that end, another focus of the Commission is examining and improving our equity market structure.

Over the past two years, the Commission has completed a number of initiatives designed to help improve and modernize the structure of our equity markets. For example, last year the Commission adopted rules to implement the Transaction Fee Pilot, which is designed to gather data to help us assess whether the rules governing exchange access fees continue to promote fair, orderly and efficient markets.[41] The Commission has also adopted a number of transparency initiatives, including rules designed to promote greater transparency in the broker order routing

[37] *See* Press Release 2018-103, SEC Modernizes the Delivery of Fund Reports and Seeks Public Feedback on Improving Fund Disclosure (June 5, 2018), *available at* https://www.sec.gov/news/press-release/2018-103.
[38] *See* Press Release 2018-246, SEC Proposes Disclosure Improvements for Variable Annuities and Variable Life Insurance Contracts (Oct. 30, 2018), *available at* https://www.sec.gov/news/press-release/2018-246.
[39] *See* Press Release 2019-39, SEC Proposes Offering Reforms for Business Development Companies and Registered Closed-End Funds (Mar. 20, 2019), *available at* https://www.sec.gov/news/press-release/2019-39.
[40] *See* Fall 2019 Regulatory Flexibility Agenda, *supra* note 18.
[41] *See* Press Release 2018-298, SEC Adopts Transaction Fee Pilot for NMS Stocks (Dec. 19, 2018), *available at* https://www.sec.gov/news/press-release/2018-298.

practices and in alternative trading systems.[42] Led by the Division of Trading and Markets (Trading and Markets), these modernization efforts have continued over the past year.

*Thinly Traded Securities.* The quality of our markets for thinly traded securities is one area in particular that I believe is in need of review. Last year, staff from the Division of Trading and Markets (Trading and Markets) held a roundtable where participants representing a wide spectrum of viewpoints discussed the particular challenges facing companies and investors in this segment of the market.[43] A key takeaway we heard from issuers, exchanges and other market participants is that a one-size-fits-all approach to equity market structure may not work for many of our public issuers, particularly small and medium-sized companies. To that end, in October 2019, the Commission issued a statement inviting exchanges and other market participants to submit innovative proposals designed to improve the secondary market structure for these securities, including proposals for market structure innovations in conjunction with the potential suspension or termination of unlisted trading privileges and possible exemptive relief from Regulation NMS and other rules under the Exchange Act.[44] I look forward to seeing proposals geared to enhance trading and liquidity for this segment of the market while maintaining or improving market integrity.

*Market Data.* The SEC is also evaluating options for addressing issues related to the dissemination of and access to market data. At last year's market data and market access roundtable, a key topic was the evolution in recent years of market data products and market access services, both those provided by the central securities information processors (SIPs) and those provided directly by national securities exchanges.[45] In October 2019, the Commission proposed to amend Rule 608 of Regulation NMS to rescind a provision that allows a proposed amendment to a national market system plan to become effective upon filing if the proposed amendment establishes or changes a fee or other charge.[46] If the proposal is adopted, these SIP data fees, as well as all other NMS plan fees, would first provide an opportunity for public comment prior to effectiveness. In the coming year, I expect the Commission to continue to consider issues surrounding infrastructure, governance and transparency in the areas of market data distribution and market access.[47]

*OTC Equities and the "PiggyBack" Exception.* To modernize its rules to align with changes that have taken place in the over-the-counter (OTC) market over the past 30 years, and

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[42] *See* Press Release 2018-136, SEC Adopts Rules to Enhance Transparency and Oversight of Alternative Trading Systems (Jul. 18, 2018), ***available at*** https://www.sec.gov/news/press-release/2018-136.
[43] *See* Press Release 2018-65, SEC Staff to Host Roundtable on Market Structure for Thinly-Traded Securities (Apr. 13, 2018), ***available at*** https://www.sec.gov/news/press-release/2018-65.
[44] *See* Press Release 2019-217, SEC Issues Statement on Market Structure Innovation for Thinly Traded Securities (Oct. 17, 2019), ***available at*** https://www.sec.gov/news/press-release/2019-217.
[45] *See* Press Release 2018-210, SEC Staff to Host Roundtable on Market Data and Market Access (Sep. 24, 2018), ***available at*** https://www.sec.gov/news/press-release/2018-210.
[46] *See* Press Release 20119-204, SEC Proposes to Require Proposed NMS Plan Fee Amendments to Follow Public Notice, Comment, and Approval Procedure (Oct. 1, 2019), ***available at*** https://www.sec.gov/news/press-release/2019-204.
[47] *See* Fall 2019 Regulatory Flexibility Agenda, *supra* note 18; *see also* Chairman Jay Clayton and Brett Redfearn, Director, Division of Trading and Markets, Equity Market Structure 2019: Looking Back and Moving Forward, Remarks at Gabelli School of Business, Fordham University (Mar. 8, 2019), ***available at*** https://www.sec.gov/news/speech/clayton-redfearn-equity-market-structure-2019.

in addition to efforts to detect and address fraudulent conduct through enhanced examination and enforcement programs, the Commission also has taken steps to be more proactive in protecting retail investors from incidents of fraud and manipulation in OTC securities. At the 2018 roundtable to discuss initiatives to combat retail fraud, participants questioned the effectiveness of Rule 15c2-11, which mandates what actions broker-dealers must take prior to publishing quotations for securities that do not trade on a national securities exchange and which has not been updated since before it was commonplace to distribute disclosure materials and quotations electronically.[48] In particular, participants raised significant concerns about the rule's piggyback exception, which allows broker-dealers to publish quotations for a security based on the quotations of a broker-dealer that initially performed the required information review. The lack of current, publicly available information about a company allowed by this exception may particularly disadvantage retail investors. In September 2019, the Commission proposed a rule designed to update Rule 15c2-11 to more effectively protect retail investors from fraud and manipulation in these types of securities transactions.[49] Put simply, these amendments to Rule 15c2-11 are intended to improve issuer disclosures and make it easier to detect, deter and prevent fraud in our OTC markets. I believe attention to these issues will prevent harm to investors, enhance capital formation and is long overdue.

*Fixed Income Market Structure and the FIMSAC.* Our fixed income markets are also critical to our economy and our Main Street investors, though, historically, substantially less attention has been focused on the structure of these markets relative to the equity markets. With large numbers of Americans retiring every month and needing investment options, fixed income products are increasing in their importance to Main Street investors. Yet, many of those investors may not appreciate that the markets for fixed income products differ significantly from the equity markets.

The Fixed Income Market Structure Advisory Committee (FIMSAC), formed in 2017, has provided the Commission with diverse perspectives on the structure and operations of the U.S. fixed income markets, as well as advice and recommendations on matters related to fixed income market structure.[50] Since its inception, the FIMSAC has made ten recommendations on nine topics. These recommendations include ideas to improve transparency and promote liquidity for both institutional and retail investors in the corporate bond and municipal securities markets, to rethink the way we regulate electronic trading and to improve investor education about fixed income products, among others.[51] As reflected in its most recent meeting on November 4, 2019, the FIMSAC continues to consider significant fixed income topics, including

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[48] *See* Press Release 2018-200, SEC Staff to Host Roundtable on Regulatory Approaches to Combating Retail Investor Fraud (Sep. 18, 2018), *available at* https://www.sec.gov/news/press-release/2018-200.

[49] *See* Press Release 2019-189, SEC Proposes Amendments to Enhance Retail Investor Protections – Actions Increase Availability of Issuer Information and Modernize the Rule Governing Quotations for Over-the-Counter Securities (Sep. 26, 2019), *available at* https://www.sec.gov/news/press-release/2019-189.

[50] *See* Press Release 2017-209, SEC Announces the Formation and First Members of Fixed Income Market Structure Advisory Committee (Nov. 9, 2017), *available at* https://www.sec.gov/news/press-release/2017-209. The FIMSAC currently has five subcommittees: (1) Corporate Bond Transparency; (2) Municipal Securities Transparency; (3) ETFs and Bond Funds; (4) Technology and Electronic Trading; and (5) Credit Ratings.

[51] *See* Fixed Income Market Structure Advisory Committee, *available at* https://www.sec.gov/spotlight/fixed-income-advisory-committee.

rating agency compensation models, index construction and LIBOR transition.[52] In order to give the FIMSAC adequate time to engage with the Financial Industry Regulatory Authority (FINRA) and other interested parties as its recommendations are considered, the FIMSAC's tenure was recently extended for another year.[53] I look forward to continuing to engage with the FIMSAC and its members on initiatives to help improve these markets.

***Consolidated Audit Trail***

The implementation of the consolidated audit trail, or CAT, continues to be an important regulatory initiative. The CAT, first proposed in 2012 and mandated by the Commission pursuant to an NMS Plan in 2016, is intended to enhance regulatory oversight of our securities markets. Our equities and options markets operate through multiple exchanges and other venues and the CAT will facilitate cross-market oversight and analysis, thereby improving investor protection and market integrity.

Progress on the CAT has been much slower than initially anticipated due to a number of factors. I believe progress is being made but continued progress will require substantial additional Commission attention and resources. Commission staff has been engaging with the SROs with a focus on trying to ensure that project management, resource and governance deficiencies are addressed, including development of a credible and comprehensive work plan with verifiable milestones. In addition, at the beginning of this year, I appointed a senior-level staff person with substantial project management experience to coordinate the Commission's efforts to monitor the development of the CAT.[54]

The SROs have made positive changes to address identified deficiencies in the NMS plan and prior development efforts, including the development of a Master Plan with projected implementation milestones and the appointment of a leadership team that appears to be working cooperatively toward achieving solutions. Also, at our urging, the SROs increased the role of Advisory Committee members and other industry representatives in the implementation process. This increased transparency with the industry appears to have benefited the project overall.

To reduce the likelihood of further unnecessary or unanticipated delays in the implementation of the CAT and to increase the transparency of the implementation process for market participants who must bring their systems into compliance with the CAT, in September 2019, the Commission proposed amendments to the CAT NMS Plan to require the SROs to file with the Commission and to make publicly available an implementation plan and quarterly progress reports.[55] The proposed amendments also would establish provisions designed to introduce financial accountability and promote senior management attention to implementation in order to help ensure the SROs meet certain CAT implementation milestones in a timely fashion.

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[52] *See* https://www.sec.gov/spotlight/fixed-income-advisory-committee/fimsac-agenda-110419.htm.
[53] *See* Fixed Income Market Structure Advisory Committee, Release No. 34-87482 (Nov. 7, 2019), *available at* https://www.sec.gov/rules/other/2019/34-87482.pdf.
[54] *See* Press Release 2019-5, SEC Names Manisha Kimmel as Senior Policy Advisor to the Chairman on the Consolidated Audit Trail (Jan. 29, 2019), *available at* https://www.sec.gov/news/press-release/2019-5.
[55] *See* Press Release 2019-173, SEC Proposes Transparency and Financial Accountability Amendments to the CAT NMS Plan (Sep. 9, 2019), *available at* https://www.sec.gov/news/press-release/2019-173.

The protection of sensitive information submitted to the CAT continues to be of paramount importance, and I share many of the concerns that have been raised about the protection of any investors' PII that would be stored in the CAT. The Commission and the SROs must be mindful of the volume of data that the CAT collects and its sensitive nature and be responsible in their collection and use of that data. To that end, I support the SROs' ongoing efforts to address various PII and data protection concerns. The SROs recently submitted a request for an exemption to remove the most sensitive PII—social security numbers, account numbers and full dates of birth—from the CAT. I believe the regulatory objectives of the CAT can be achieved without these most sensitive pieces of investor information. If granted, the only retail investor PII remaining in the CAT would be essentially "phone book" type information—name, address and birth year.

Even with efforts to significantly reduce the scope of PII included in the CAT, the nature of the data to be included in the CAT necessitates robust security protections. The CAT NMS Plan developed by the SROs includes specific security requirements designed to mitigate the risk of a breach of the CAT and the possibility of misuse of data reported to the CAT.[56] Looking ahead, I believe we can and should take additional steps to ensure the security and confidentiality of CAT data, including in response to developments in data systems and cybersecurity. To that end, I expect the Commission will consider data security amendments to the CAT NMS Plan in the coming year.[57] Further, with regard to the use of the CAT by the SEC, as I have previously noted, the SEC will not retrieve any sensitive PII from the CAT unless there is a regulatory need for the information and we are confident that there are appropriate protections in place to safeguard the information.

***Distributed Ledger Technology and Digital Assets***

The Commission and its staff continue to focus a significant amount of attention and resources on digital assets. As I have previously stated, I am optimistic that developments in distributed ledger technology can help facilitate capital formation, providing promising investment opportunities for both institutional and Main Street investors. Overall, I believe we have taken a measured, yet proactive regulatory approach that both fosters innovation and capital formation while protecting our investors and our markets.

A significant portion of this work takes place in the SEC's FinHub.[58] FinHub serves as an internal resource within the SEC, coordinating the staff's work on FinTech-related issues across offices and divisions. SEC staff also meets regularly with staff from other regulatory agencies—domestic and international—to coordinate efforts and identify any areas where additional regulatory oversight may be needed. FinHub also serves as a portal for public

[56] The security features required by the CAT NMS Plan include, among other things: (1) the encryption of PII and all other CAT data, as well as a System Security Plan; (2) adherence to the NIST 800-53 security standards, a set of security and privacy controls for federal information systems and organizations; (3) incorporation of tools that will enable logging, auditing and access controls for the CAT system; (4) secure methods of connectivity; and (5) development of a Cyber Incident Response Plan.

[57] *See* Fall 2019 Regulatory Flexibility Agenda, *supra* note 18.

[58] Staffed by representatives from across the Commission, FinHub is intended to serve as a public resource for FinTech-related issues at the SEC, including matters dealing with distributed ledger technology, automated investment advice, digital marketplace financing and artificial intelligence/machine learning.

engagement. In May 2019, FinHub hosted a public FinTech forum focusing on distributed ledger technology and digital assets and explored topics such as ICOs, digital asset platforms and how these technologies impact investors and the markets.[59]

Additionally, FinHub and other SEC staff meet regularly with entrepreneurs and market professionals interested in developing new and innovative investment products in compliance with the federal securities laws, including through local, peer-to-peer meetings across the country. SEC staff has also provided information to help market participants assess whether the federal securities laws apply to a particular digital asset.[60] As the work of FinHub and our other activities demonstrate, the agency is focused on issues presented by new technologies, and our door remains open to those who seek to innovate and raise capital in accordance with the federal securities laws and consistent with important investor protections.[61]

***Interagency Efforts and Other Dodd-Frank Rulemakings***

Completing Title VII Rulemaking and Standing Up the Title VII Framework. As I have previously testified, we have made finalizing Dodd-Frank's Title VII regulatory regime a priority, and the Commission has made significant progress to that end over the past year. In particular, in June 2019, the Commission adopted capital, margin and segregation rules designed to protect the counterparties of security-based swap dealers and major security-based swap participants, thereby reducing risk to the market as a whole.[62] In September 2019, the Commission also adopted recordkeeping and reporting rules, which will require the creation and retention of fundamental business records that facilitate the Commission's ability to monitor compliance with requirements designed to protect financial responsibility and reduce risk to the market.[63] Finally, the Commission proposed rules to improve the framework for regulating

[59] *See* Press Release 2019-59, SEC Staff Announces Agenda for May 31 FinTech Forum (Apr. 24, 2019), *available at* https://www.sec.gov/news/press-release/2019-59.

[60] For example, FinHub released a framework for investment contract analysis for digital assets, and Trading and Markets, along with FINRA, released a joint staff statement relating to custody of digital assets. *See* Framework for "Investment Contract" Analysis of Digital Assets, *available at* https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets; Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities (July 8, 2019), *available at* https://www.sec.gov/news/public-statement/joint-staff-statement-broker-dealer-custody-digital-asset-securities. Investment Management has also been engaging with the asset management industry on issues related to fund investment in digital assets, including those related to valuation, custody and liquidity, among others. *See* Staff Letter and Responses on Engaging on Fund Innovation and Cryptocurrency-related Holdings, *available at* https://www.sec.gov/investment/fund-innovation-cryptocurrency-related-holdings.

[61] *See, e.g.*, Response of the Division of Trading and Markets re: Paxos Trust Company, LLC (Oct. 28, 2019), *available at* https://www.sec.gov/divisions/marketreg/mr-noaction/2019/paxos-trust-company-102819-17a.pdf; Response of the Division of Corporation Finance re: Pocketful of Quarters, Inc. (July 25, 2019), *available at* https://www.sec.gov/corpfin/pocketful-quarters-inc-072519-2a1; Response of the Division of Corporation Finance re: TurnKey Jet, Inc. (Apr. 3, 2019), *available at* https://www.sec.gov/divisions/corpfin/cf-noaction/2019/turnkey-jet-040219-2a1.htm.

[62] *See* Press Release 2019-105, SEC Adopts Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Amends the Capital and Segregation Requirements for Broker-Dealers (June 21, 2019), *available at* https://www.sec.gov/news/press-release/2019-105.

[63] *See* Press Release 2019-182, SEC Adopts New Rules and Amendments under Title VII of Dodd-Frank (Sept. 19, 2019), *available at* https://www.sec.gov/news/press-release/2019-182.

cross-border security-based swap transactions and market participants,[64] and I expect the Commission will consider final rule recommendations in the near future. If adopted, these amendments would mark an important milestone in standing up Title VII by triggering the implementation period for compliance with the security-based swap regime, as well as the previously adopted reporting and recordkeeping requirements and capital and margin requirements. As part of this effort, SEC staff has been actively engaged with our counterparts at the Commodity Futures Trading Commission (CFTC) to explore ways to further harmonize the Commission's security-based swap rules with the swap rules developed by the CFTC to increase effectiveness and reduce complexity and costs.[65]

Addressing Ambiguities and Implementation Difficulties with the Volcker Rule. In addition to continued discussions with the CFTC regarding Title VII harmonization, the Commission and staff have engaged with our fellow financial regulators—the Federal Reserve, Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC) and CFTC (collectively, the Volcker agencies)—to address other issues in our combined markets in a consistent manner. Since the adoption of the Volcker Rule in 2013, the Volcker agencies have gained experience through its implementation, including through examinations. Based on that experience, and in response to feedback received in the course of administering the Volcker Rule, we and the other Volcker agencies identified opportunities—consistent with the statute—for improving its implementation. Recently, the Volcker agencies adopted amendments to the Volcker Rule to tailor its requirements based on the level of a banking entity's trading activity.[66] These amendments provide greater certainty for banking entities seeking to engage in certain statutorily permitted activities, in addition to clarifying activity that is not permitted under the rule.

Additionally, the amendments effect the changes to the covered funds-related provisions of the Volcker Rule. Specifically, these amendments modify the conditions to certain existing exemptions for permitted activities involving ownership interests in covered funds. As the adopting release made clear, the Volcker agencies are continuing to consider the comments received in response to the 2018 proposal on additional aspects of the covered funds provisions and intend to address those comments in a separate rulemaking. I look forward to working with our colleagues at the other agencies on that endeavor.

In response to congressional directives, the Volcker agencies adopted amendments to exclude community banks from the Volcker Rule, as well as to permit a hedge fund or private equity fund, under certain circumstances, to share the same name or a variation of the same name

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[64] *See* Press Release 2019-69, SEC Proposes Actions to Improve Cross-Border Application of Security-Based Swap Requirements (May 10, 2019), *available at* https://www.sec.gov/news/press-release/2019-69.

[65] To further this cooperation, in 2018 the SEC and CFTC executed a memorandum of understanding (MOU), which explicitly acknowledges shared regulatory interests between the agencies—including, but not limited to, Title VII—and reconfirms our commitment to work together to facilitate efficient markets for the benefit of all market participants. *See* Press Release 2018-114, SEC and CFTC Announce Approval of New MOU (June 28, 2018), *available at* https://www.sec.gov/news/press-release/2018-114.

[66] *See* Press Release 2019-207, Agencies Finalize Changes to Simplify Volcker Rule (Oct. 8, 2019), *available at* https://www.sec.gov/news/press-release/2019-207.

with an investment adviser as long as the adviser is not an insured depository institution, a company that controls an insured depository institution or a bank holding company.[67]

**Enforcement and Compliance**

***Pursuing Enforcement Matters that are Meaningful to Main Street Investors***

The ongoing efforts by the Division of Enforcement (Enforcement) to deter misconduct and punish securities law violators are critical to safeguarding millions of investors and instilling confidence in the integrity of our markets. The nature and quality of the SEC's enforcement actions during the last year speak volumes to the hard work of the women and men of the agency. Their efforts over the past year have made our capital markets a safer place for investors to put their hard-earned money to work.

To that end, in FY 2019, Enforcement investigated and recommended a broad mix of enforcement actions that addressed a variety of misconduct across the spectrum of the securities markets. Overall, the Commission brought 862 enforcement actions and obtained judgments and orders totaling more than $4.3 billion in disgorgement and penalties, while returning nearly $1.2 billion to harmed investors.[68] To be sure, as I and our Co-Directors of Enforcement have noted on various occasions, these types of purely quantitative measures alone cannot adequately measure the effectiveness of Enforcement's work, which can be evaluated better by assessing the nature, quality and effects of each of the Commission's enforcement actions with an eye toward how they further the agency's mission.

The Commission's enforcement actions over the last year have covered a broad range of subject areas, including investment management, securities offerings, issuer reporting and accounting, market manipulation, insider trading, broker-dealer activities, cyber-related conduct and Foreign Corrupt Practices Act (FCPA) violations, among many others. In this testimony, I would like to highlight three investor-oriented Enforcement initiatives: (1) the Retail Strategy Task Force (RSTF) and its efforts to protect our teachers, service members and seniors; (2) the Cyber Unit; and (3) Enforcement's work in returning funds to harmed investors.

Since its formation in 2017, the RSTF has continued its innovative work on case-generation initiatives, education and outreach efforts focusing on misconduct affecting retail investors.[69] Recognizing that prevention and enforcement are complementary efforts, the RSTF is working with the SEC's Office of Investor Education and Advocacy (OIEA) on two Commission-wide initiatives: the Teacher's Initiative and the Military Service Members'

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[67] *See* Press Release 2019-124, Agencies Adopt Final Rule to Exclude Community Banks from the Volcker Rule (July 9, 2019), *available at* https://www.sec.gov/news/pressrelease/2019-124.
[68] *See* U.S. Sec. and Exch. Comm'n, Div. of Enforcement Annual Report (2019), *available at* https://www.sec.gov/files/enforcement-annual-report-2019.pdf [hereinafter 2019 Enforcement Report].
[69] The RSTF has two primary objectives: (1) to develop data-driven, analytical strategies for identifying practices in the securities markets that harm retail investors and generating enforcement matters in these areas; and (2) to collaborate within and beyond the SEC on retail investor advocacy and outreach. *See* Press Release 2017-176, SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors (Sep. 25, 2017), *available at* https://www.sec.gov/news/press-release/2017-176.

Initiative.[70] Teachers, active duty military and veterans provide a tremendous service to our country, often at great personal and financial sacrifice to themselves and their families. However, they are often targeted and fall victim to securities fraud and other misconduct. These initiatives focus additional enforcement efforts on harmful practices and investment fraud targeted at these communities. The initiative also focuses investor education resources on instructing teachers, veterans and active duty military personnel on savings and investment, including investment fees and expenses, retirement programs specific to educators and service members and identifying the red flags of investment fraud.

Protecting older Americans from investor fraud is another important mission of the RSTF. The SEC is very concerned about financial exploitation of and investment fraud against seniors. Recently, the RSTF held a roundtable on combatting elder investor fraud that focused on the types of fraudulent and manipulative schemes commonly used to target seniors and potential steps that regulators, financial professionals and others can take to identify and combat elder investor fraud.[71]

With its expertise, Enforcement's Cyber Unit continues to focus on, among other things, potential violations involving distributed ledger technology, cyber intrusions and hacking to obtain material, non-public information. Cyber Unit staff members work closely with FinHub on cases involving distributed ledger technology and digital assets. This past year, the Commission has brought actions against a number of issuers of digital assets for allegedly engaging in fraud and for violating the registration provisions of the federal securities laws. The Commission also filed charges related to the unlawful promotion of initial coin offerings (ICOs) and the unlawful operation of a digital asset trading platform.[72] Additionally, the SEC filed an emergency action to block an alleged unregistered, ongoing, public digital token offering in the United States that has raised more than $1.7 billion of investor funds.[73] Collectively, these actions reflect the Commission's commitment to policing these markets vigorously and to taking enforcement action, as appropriate, against those who engage in misconduct related to digital assets that violates the federal securities laws. The Cyber Unit and Enforcement as a whole have also continued to focus on cybersecurity threats to public companies and regulated entities, including our public company disclosure requirements.

Finally, in my view, protecting retail investors also means, whenever possible, putting money back in their pockets as soon as possible after they are harmed by violations of the federal securities laws. We also have continued our efforts to return funds to harmed investors as promptly as practicable. From FY 2017 through FY 2019, the Commission has returned more than $3 billion to harmed investors, with nearly $1.2 billion returned this past fiscal year. We remain committed to this important part of our work, and we will continue our efforts to return funds to victims with greater efficiency this year as well.

[70] *See* Press Release 2019-85, SEC Announces Enforcement and Investor Education Initiatives to Protect Teachers and Military Service Members (June 3, 2019), *available at* https://www.sec.gov/news/press-release/2019-85.
[71] *See* Press Release 2019-192, SEC Retail Strategy Task Force to Host Roundtable on Combating Elder Investor Fraud (Sep. 26, 2019), *available at* https://www.sec.gov/news/press-release/2019-192
[72] *See* Cyber Enforcement Actions, *available at* https://www.sec.gov/spotlight/cybersecurity-enforcement-actions.
[73] *See* Press Release 2019-212, SEC Halts Alleged $1.7 Billion Unregistered Digital Token Offering (Oct. 11, 2019), *available at* https://www.sec.gov/news/press-release/2019-212.

Reflecting this commitment, in February 2018, Enforcement launched the Share Class Selection Disclosure Initiative, a self-reporting initiative designed to address disclosure failures by investment advisers regarding their conflicts of interest as a result of their receipt of compensation in the form of 12b-1 fees.[74] As part of this initiative, in FY 2019, 95 investment advisory firms voluntarily self-reported to Enforcement and were ordered by the Commission to return a total of over $135 million to affected investors—the vast majority of whom are retail investors.[75] The voluntary, self-reporting and self-remediation features of this initiative allowed the Commission to leverage its resources to address disclosure failures in a very short period of time, resulting in the immediate benefit of money being ordered returned to harmed investors and the lasting benefit of improved disclosure.

The Supreme Court's decision in *Kokesh v. SEC*,[76] however, has impacted our ability to return funds fraudulently taken from Main Street investors. In *Kokesh*, the Supreme Court found our use of the disgorgement remedy may have operated as a penalty, which prohibited the Commission from seeking disgorgement of ill-gotten gains beyond the five-year statute of limitations applicable to penalties. Said simply, the *Kokesh* decision has had the anomalous effect of allowing the most "successful" perpetrators of fraud—those whose frauds are well-concealed and stretch beyond the five-year limitations period—to keep their ill-gotten gains. Since *Kokesh* was decided, an estimated $1.1 billion in ill-gotten gains has been unavailable for possible distribution to harmed investors, much of which is tied to losses by investors.[77] More recently, the SEC's ability to seek disgorgement in any district court action has been questioned.[78]

I agree that statutes of limitations serve important functions in our legal system, and for important public policy reasons, actions should have reasonable limitations periods.[79] For example, civil and criminal authorities, including the SEC, should do everything in their power to bring appropriate actions swiftly and should be incentivized to do so. In addition, in our markets, particularly our public markets, the certainty brought by reasonable limitations periods has significant value for all investors.[80] However, as I look across the scope of misconduct we encounter, including most notably Ponzi schemes and affinity frauds, I am troubled by the substantial amount of losses that we have not been able to recover for Main Street investors. Allowing clever fraudsters to keep their ill-gotten gains at the expense of our Main Street investors—particularly those with fewer savings and more to lose—is inconsistent with basic

[74] *See* Press Release 2018-15, SEC Launches Share Class Selection Disclosure Initiative to Encourage Self-Reporting and the Prompt Return of Funds to Investors (Feb. 12, 2018), ***available at*** https://www.sec.gov/news/press-release/2018-15.
[75] *See* 2019 Enforcement Report, ***supra*** note 68.
[76] 137 S. Ct. 1635 (2017).
[77] *See id.*
[78] The U.S. Supreme Court recently granted certiorari in *Liu v. SEC*, No. 18-1501, to address this question.
[79] Indeed, the Commission's cases have the greatest impact when they are filed as close in time to the conduct as possible. Our Enforcement Division is focused on accelerating the pace of investigations and has made notable progress in this respect over recent years. We are committed to bringing meaningful actions promptly, and I would not expect any changes to the limitations period applicable to disgorgement claims to deter us from this effort.
[80] To be clear, I am less concerned about the restraints of a five-year limitations period for disgorgement action in our public capital markets where there are more causes of action and safeguards available to protect investors and to remediate harm.

fairness and undermines the confidence that our capital markets are fair and efficient and provide Americans with opportunities for a better future.

I greatly appreciate the bipartisan, bicameral work underway to address this issue, and I welcome the opportunity to continue to work with Congress to ensure the Commission is able to seek recoveries in cases of well-concealed, long-running frauds so that defrauded retail investors can get their investment dollars back while remaining true to the principles embedded in statutes of limitations.[81]

***Protecting Investors and Improving Investment Options by Promoting Compliance***

The SEC's Office of Compliance Inspections and Examinations (OCIE) is responsible for conducting examinations of entities registered with the SEC, including more than 13,400 investment advisers, approximately 10,000 mutual funds and ETFs, roughly 3,700 broker-dealers, about 350 transfer agents, seven active clearing agencies, 24 national securities exchanges, nearly 550 municipal advisors, FINRA and the Municipal Securities Rulemaking Board (MSRB), as well as the Securities Investor Protection Corporation and the Public Company Accounting Oversight Board (PCAOB), among others. The results of OCIE's examinations are used by the SEC to identify and monitor risks, promote compliance and improve industry practices, pursue misconduct and inform rulemaking initiatives.

OCIE's 2019 Examination Priorities reflect a continued focus on the SEC's commitment to protecting retail investors—including seniors and those saving for retirement.[82] In particular, OCIE has looked closely at products and services offered to retail investors, the disclosures they receive about those investments and the financial services professionals who serve them, as well as several other areas that present heightened risk, including compliance and risks in critical market infrastructure, cybersecurity and anti-money laundering programs. OCIE also publishes a number of risk alerts to inform registered firms and investors of common compliance issues to aid in the identification and correction of potentially deficient practices to better protect the interests of Main Street investors. During FY 2019, OCIE published eight risk alerts—the most risk alerts in a year since we began publishing them in FY 2011.[83]

During FY 2019, OCIE conducted over 3,075 examinations, a slight decrease from FY 2018.[84] This includes a 15 percent coverage ratio for investment advisers—up from 10 percent five years ago, even as the number of registered investment advisers continues to grow. In FY 2019, OCIE's examinations also resulted in firms returning more than $70 million thus far in recoveries. Staff will continue to leverage data analysis to identify potentially problematic

[81] *See* S. 799, the Securities Fraud Enforcement and Investor Compensation Act of 2019; S. 2563, the Illicit Cash Act; and H.R. 4344, the Investor Protection and Capital Markets Fairness Act, which passed the U.S. House of Representatives with bipartisan support on November 18, 2019.

[82] U.S. Sec. and Exch. Comm'n, Off. of Compliance Inspections and Examinations, 2019 Nat'l Exam Program Examination Priorities (Dec. 20, 2018), *available at* https://www.sec.gov/files/OCIE%202019%20Priorities.pdf.

[83] See Off. of Compliance Inspections and Examinations Risk Alerts, *available at* https://www.sec.gov/ocie.

[84] Due to the lapse in appropriations in 2019, we have seen a decline in certain FY 2019 metrics as compared to prior years. As such, and as noted earlier with regard to Enforcement, I believe a purely quantitative approach to evaluating performance is insufficient.

activities and firms as well as to determine how best to scope the examinations of those activities and firms.

**Increasing Engagement with Investors and Market Participants**

In addition to our regulatory agenda, the Commission has another important agenda—what I call our "engagement agenda." To effectively fulfill our responsibility to American investors and markets, it is essential that the SEC maintain an open line of communication with investors and other market participants. In FY 2019, following on our work in FY 2018, the SEC substantially increased its engagement with investors and an array of market participants to help us improve our work and better focus our resources and efforts.

***Empowering Main Street Investors through Education and Outreach***

In addition to strong enforcement of our securities laws, the SEC is fulfilling its mandate through robust investor education and outreach programs to promote informed investment decision-making and provide the investing public with a better understanding of our capital markets, as well as the opportunities and risks associated with the array of investment choices presented to them. Based on my experiences traveling the country and meeting with investors, two common themes have emerged, regardless of demographics or geography: investors wish (1) they had started investing earlier in our markets; and (2) they had known more about investing and financial markets more generally. The sentiment, which was universal and deeply held, continues to resonate with me—and I intend to continue to work to address them—during my tenure as Chairman. As part of this, we will continue to hold additional town hall-style meetings with Main Street investors in 2020.

OIEA spearheads our investor education efforts, and participation extends throughout our divisions and offices. Through its "Before You Invest, Investor.gov" public service campaign, OIEA is focused on empowering retail investors through information and education, including raising awareness about Investor.gov and helping individuals protect themselves from investment fraud. The SEC's investor education platform covers a wide variety of subjects and uses multiple communication channels. In addition to in-person outreach, the Commission is modernizing our educational efforts by developing informative, innovative and accessible educational initiatives designed to reach more people sooner, including through digital and social media. We also partner with advocates who are providing important feedback on our content so that we can reach the broadest cross-section of our society.

In FY 2019, SEC staff across the country participated in over 500 in-person outreach events. This outreach included events targeted for senior citizens, educators, current and former military personnel, younger investors and other traditionally underserved communities. For example, as part of the Teachers Initiative discussed above, the Commission has launched several teacher investment outreach efforts nationwide with a focus on educators, including a podcast series, local events at schools and seminars, as well as a conference on investment challenges facing educators and ideas for improvement. SEC staff frequently engages with the public in various locations, including community centers and libraries. OIEA has programs for investors that can be delivered locally, and we welcome the opportunity to work with your offices to conduct nonpartisan, investor education and outreach events. If such programs would be of interest, the Office of Legislative and Intergovernmental Affairs and OIEA can work with your staff to tailor a presentation to the needs of the audience.

***Engagement with Market Participants***

Our capital markets are far different today than they were a decade ago. They are increasingly global and highly data dependent. Investments are channeled through intermediaries and vehicles, such as mutual funds and ETFs, to a much greater extent. Our markets also are ever changing and the pace of that change has increased. It is essential that the SEC understand the markets of today and continually prepare for and adjust to market developments. As a result, engagement with those who participate in our markets extensively, including public and private companies, institutional investors, broker-dealers and auditors, as well as those who monitor and oversee markets, including U.S. and foreign authorities,[85] elected officials, analysts and academics, is essential.

Recognizing that asset management is a critical component of our markets and is especially important to Main Street investors, in October 2019, the Commission formed a new Asset Management Advisory Committee to provide the Commission with diverse perspectives on asset management and related advice and recommendations.[86] This Committee will help the Commission ensure that our regulatory approach to asset management meets the needs of retail investors and market participants at a time when the industry is evolving rapidly.

Engaging with America's entrepreneurs is also important to our mission, including, in particular, our capital formation mandate. In December 2018, our first Advocate for Small Business Capital Formation was appointed to oversee the SEC's newest office dedicated to advancing the interests of small businesses and their investors at the SEC and in our capital markets.[87] The SEC's Office of the Advocate for Small Business Capital Formation (OASB) gives entrepreneurs and small business investors new avenues to engage with the SEC and navigate opportunities for capital formation, ranging from start-up companies to small-cap companies. In August 2019, OASB hosted the SEC's 38th annual Government-Business Forum on Small Business Capital Formation (Forum), preceded by the second meeting of the Small Business Capital Formation Advisory Committee, in Omaha, Nebraska.[88] All five Commissioners attended and participated in the Forum, which provided an opportunity to hear from entrepreneurs, investors and other market participants on capital formation in the heartland.

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[85] The SEC plays an active role and contributes to and benefits from participation in various domestic and international organizations that focus on market and systemic risks, including the Financial and Banking Information Infrastructure Committee (FBIIC), Global Financial Innovation Network (GFIN); Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO). As Chairman, I am also a member of the Financial Stability Oversight Council (FSOC). In addition to engagement with these and other organizations, we also directly coordinate and share information and observations on almost a daily basis with our domestic regulatory counterparts at the Treasury Department, the CFTC and the Federal Reserve, among others.
[86] *See* Press Release 2019-208, SEC Announces the Formation of Asset Management Advisory Committee (Oct. 9, 2019), *available at* https://www.sec.gov/news/press-release/2019-208.
[87] *See* Press Release 2018-304, Martha Miller Named Advocate for Small Business Capital Formation (Dec. 21, 2018), *available at* https://www.sec.gov/news/press-release/2018-304.
[88] *See* SEC's 38th Annual Government-Business Forum on Small Business Capital Formation (Aug. 14, 2019), *available at* https://www.sec.gov/oasb/sbforum.

Last week, the SEC released the Annual Report from the Forum, and I am pleased the SEC has many of the report's recommendations under consideration.[89]

OASB has led over 20 outreach events in its first year, from roundtables to town halls to keynote speeches, in addition to one-on-one engagements. These events, which have included targeted outreach to women, minority, veteran-owned and rural businesses, empower small businesses and their investors by providing opportunities to impact policy and give feedback on ways the SEC can support capital formation. OASB also initiated a series of short videos available online that provide a high-level summary of recent SEC rulemakings, as well as how to comment on rules more generally.[90] By engaging small businesses and their investors, the SEC is engaging broader and more diverse voices to ensure capital formation opportunities are available to everyone.

Additionally, leadership in our divisions and offices, as well as our dedicated staff, is open to hearing from and meeting with investors and market participants on areas where our markets are not working as they should or can be improved—particularly as it relates to our long-term Main Street investors.

***Engagement with and Oversight of Self-Regulatory Organizations***

The SEC has oversight of self-regulatory organizations (SROs) such as FINRA and the Municipal Securities Rulemaking Board (MSRB), as well as the Public Company Accounting Oversight Board (PCAOB). The work of these and other oversight organizations is important to the functioning of our markets and, in particular, investor protection. For example, this past year, SEC staff in Trading and Markets and OCIE—who have day-to-day oversight of FINRA—have been working closely with FINRA on the implementation of Regulation Best Interest and a number of other matters, including the CAT. The Office of Municipal Securities primarily has day-to-day oversight of the MSRB, and over the past year, I have increased my direct attention to MSRB oversight, including meeting with several of the new Board members. With regard to our oversight of the PCAOB, the Commission exercises oversight responsibilities with respect to the PCAOB in accordance with the Sarbanes-Oxley Act, which includes approval of rules and standards adopted by the PCAOB and the approval of the PCAOB's budget, in addition to significant Board oversight. The PCAOB has faced significant challenges for some time, and while progress is being made, key challenges remain. To that end, my fellow Commissioners and I have increased our direct attention to the oversight of the PCAOB in recent months.

**Monitoring Market Developments and Risks**

Consistent with past practice, I want to close by discussing just a few of the market development and risks that we are monitoring closely at the Commission. As our markets continue to evolve, new issues and risks continually emerge, and the Commission and staff

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[89] *See* Press Release 2019-252, SEC Releases Report on 38th Annual Small Business Forum (Dec. 5, 2019), *available at* https://www.sec.gov/news/press-release/2019-252. In accordance with Section 503 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (Public Law 115-174), this Annual Report includes Commission responses to this year's Forum recommendations.

[90] *See* Small Business Capital Formation Video Gallery, *available at* https://www.sec.gov/page/oasb-videos.

across our divisions and offices must stay abreast of these changes and respond appropriately to ensure that all investors, importantly Main Street investors, have access to fair and efficient capital markets. In recognition of the SEC's role in this area, earlier this year, I created a new position, the Senior Policy Advisor for Market and Activities-Based Risk, to manage and coordinate SEC efforts to identify, monitor and respond to market risks, including activities-based risks. In addition to leading and coordinating our risk monitoring and management work, this position will enable us to work more effectively with and contribute to the efforts of the FSOC, including in respect of FSOC's activities-based approach to identifying and addressing potential risks to U.S. financial stability.

Speaking more generally, our strong relationships with our domestic and international regulatory partners have been especially beneficial as we continually monitor and respond to changes to global markets that will affect investors, market participants and our capital markets. We work very closely with staff at the Treasury Department, CFTC, Federal Reserve, OCC, and FDIC, among others, on a wide range of regulatory and market risk issues. I am grateful to Secretary Mnuchin, Chairman Powell, Vice Chairman Quarels, Chairman McWilliams, Chairman Tarbert, Comptroller Otting and our other federal financial regulatory colleagues for their openness to cooperation and their demonstrated support for the Commission's mission. On the international front, the Commission plays a significant role in the work of the FSB and IOSCO, where current topics of discussion include: (1) the increase in global government, corporate and consumer debt generally and the relative shift in debt holdings from bank balance sheets to capital markets participants; (2) the digitization of financial markets including the potential digitization of currencies; and (3) the potential effects of macroeconomic trends and factors that may have broad effects on markets, including the continuation of accommodative monetary policy, climate change, data dependency and related cyber risks and Brexit.

*Brexit.* Regarding Brexit, the Commission and SEC staff have been closely monitoring Brexit and its potential impacts on U.S. markets and investors, and more broadly, on global financial markets. The SEC's responsibility is primarily related to the impact of Brexit on U.S. capital markets, and SEC staff has been focusing on the disclosures companies and advisers make related to Brexit and the functioning of our market utilities and other infrastructure.[91] As the target date for Brexit approaches, we will continue to monitor and plan for potential Brexit-related impacts on U.S. investors and markets.

*MiFID II.* Another area of focus has been the European Union's Markets in Financial Instruments Directive II (MiFID II), which changed how asset managers could pay for research in the European Union, and in turn, has also raised questions concerning market practice and compliance among broker-dealers and asset managers in the United States. The impacts of MiFID II are evolving, and SEC staff has been actively engaging with market participants, as well as European authorities, on MiFID II's effect on the business practices of investment advisers and broker-dealers and its impact on the quality and availability of research, particularly with respect to small issuers. In 2017, Commission staff issued a series of no-action letters regarding market participants' U.S. regulated activities as they engaged in efforts to comply with MiFID II, and last month, the time frame of the staff's no-action position was extended until July

[91] *See* SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks (Dec. 6, 2018), *available at* https://www.sec.gov/news/speech/speech-clayton-120618.

2023.[92] This temporary extension will provide market participants with greater certainty while the SEC—as well as European regulators—continue to monitor and assess MiFID II's evolving impact and evaluate whether any additional guidance or regulatory actions are appropriate, and while market-based solutions with respect to payments for research evolve further. We welcome continued engagement from market participants on this issue.

*LIBOR Transition.* The SEC has increased its attention to issues raised by the expected transition away from LIBOR as a benchmark for short-term interest rates, including market function and investor protection risks. As LIBOR is used extensively in the U.S. and globally as a benchmark rate to set interest rates for various commercial and financial contracts, the discontinuation of LIBOR at the end of 2021 could have a significant impact on financial markets and may present a material risk for market participants, including public companies, exchanges, clearing agencies, investment advisers, investment companies and broker-dealers. In July 2019, staff from multiple SEC divisions and offices published a statement encouraging market participants to proactively manage their transition away from LIBOR and outlined several potential areas that may warrant increased attention during that time.[93] As I have stated on multiple occasions, market participants should assess their exposure to LIBOR and decide how to actively manage that risk, which includes ensuring that any contracts that extend beyond 2021 either (1) reference LIBOR and have effective fallback language; or (2) do not reference LIBOR.[94]

More recently, I have asked the FIMSAC to continue to monitor this issue and provide the Commission with their views on the issues we face in facilitating the transition away from LIBOR, particularly for instruments and products that have: (1) maturity dates beyond the expected LIBOR phase-out date; (2) do not have effective fallback language; and (3) from a practical perspective, could be difficult for parties to reach an agreement on an alternative rate.[95] We welcome continued engagement with, and input from, market participants as we'd continue to address the various issues presented by the expected discontinuation of LIBOR.

*Debt Markets.* Another area we are monitoring is the corporate debt markets and leveraged lending, including funds and products that invest in leveraged loans. Global debt now totals at least $246.5 trillion, or 320 percent of the world's GDP.[96] Focusing on the United States and corporate debt specifically, outstanding nonfinancial corporate debt stands at almost

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[92] *See* Press Release 2019-229, SEC Announces Extension of Temporary Measure to Facilitate Cross-Border Implementation of the European Union's MiFID II's Research Provisions (Nov. 4, 2019), ***available at*** https://www.sec.gov/news/press-release/2019-229.

[93] *See* Press Release 2019-129, SEC Staff Publishes Statement Highlighting Risks for Market Participants as They Transition Away from LIBOR (July 12, 2019), ***available at*** https://www.sec.gov/news/press-release/2019-129.

[94] To the extent required, risk may need to be disclosed to the market, counterparties and investors.

[95] *See* Remarks to the SEC Fixed Income Market Structure Advisory Committee (Nov. 4, 2019), ***available at*** https://www.sec.gov/news/public-statement/statement-clayton-fimsac-110419. I have also asked our Investor Advisory Committee to review these issues and their impact on investors. *See* Remarks to the SEC Investor Advisory Committee (Nov. 7, 2019), ***available at*** https://www.sec.gov/news/public-statement/clayton-remarks-investor-advisory-committee-110719.

[96] Alexandre Tanzi, *Global Debt Quickened in First Quarter, Outpacing World Economy* (July 15, 2019), ***available at*** https://www.bloomberg.com/news/articles/2019-07-15/global-debt-accelerated-in-1st-quarter-outpacing-world-economy.

$10 trillion and now sits at almost 50 percent of U.S. GDP.[97] Debt securities accounted for approximately 62 percent of money market fund assets (*i.e.*, liquidity-oriented products) as of the first quarter of 2019 and 56 percent as of the second quarter of 2019, near its peak of 64 percent.[98] Global government policy has shifted direct credit exposure from the banking sector to the capital markets sector and indirect credit exposure to new channels. In particular, we have observed a rise in both passive and structured investing in our credit markets, with a significant shift from debt held directly by investors to debt held through funds, including collateralized loan obligations (CLOs).[99]

To be sure, I am not saying that these aggregate debt amounts or the relative shift away from banks to the capital markets are the result of inappropriate policy decisions or in themselves systemic risks. What I am saying is that, in monitoring market risks and economic risks more broadly, we need to be cognizant of these changes. In this regard, modernizing our oversight means recognizing that shift, analyzing what it means for the application of our regulatory tools, and considering whether new or updated monitoring measures and tools are necessary or appropriate and whether old measures and tools should be given less weight or retired. To that end, the Commission has been engaged with our counterparts at other financial regulatory agencies, domestically and internationally to better understand and assess the changes in our credit markets. In particular, we are monitoring: (1) the size of corporate debt in aggregate and by industry; (2) the location and type of holders, and (3) credit quality. We are also considering the likely actions of market participants if circumstances changes.

In conjunction with our fellow U.S. and international regulators, we are also monitoring issues in other areas such as: (1) central clearing (including issues related to capital, redundancy and resilience); (2) governmental actions (including monetary and trade policy); (3) cybersecurity and data integrity (including identifying and assessing mission-critical systems); and (4) financial stability matters, more generally, understanding that these areas cannot be viewed in isolation. These are just a few of the developments in, and related risks to, the domestic and international financial markets where the SEC has focused its attention.

**Conclusion**

Thank you for the opportunity to testify today and for the Committee's continued support of the SEC, its mission and, in particular, its people. I look forward to working with this Committee and each of you to advance our mission to the benefit of our capital markets and our Main Street investors.

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[97] *See* Board of Governors of the Federal Reserve System, Nonfinancial corporate business debt securities and loans, liability, Level [BCNSDODNS], https://fred.stlouisfed.org/series/BCNSDODNS.

[98] *See* Board of Governors of the Federal Reserve System, Table L.121 of the Federal Reserve Financial Accounts, Money Market Funds, https://www.federalreserve.gov/apps/fof/DisplayTable.aspx?t=l.121.

[99] *See* DERA Economic and Risk Outlook (Nov. 2019), ***available at*** https://www.sec.gov/files/DERA_Quarterly%20Economic%20and%20Financial%20Outlook%20Dec2019.pdf.

## Appendix A

**FY 2019 One-Year Agenda (Published in the Fall of 2018)**
**(Strikeouts Reflect Completion of Indicated Stage of Rulemaking)**

| Agency | Agenda Stage of Rulemaking | Title | RIN |
|---|---|---|---|
| ~~SEC~~ | ~~Prerule Stage~~ | ~~Harmonization of Exempt Offerings~~ | ~~3235-AM27~~ |
| ~~SEC~~ | ~~Prerule Stage~~ | ~~Earnings Releases/Quarterly Reports~~ | ~~3235-AM40~~ |
| SEC | Proposed Rule Stage | Modernization of Investment Company Disclosure | 3235-AM28 |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Amendments to Financial Disclosures About Acquired Businesses~~ | ~~3235-AL77~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Business, Financial and Management Disclosure Required By Regulation S-K~~ | ~~3235-AL78~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Guide 3 Bank Holding Company Disclosure~~ | ~~3235-AL79~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Filing Fee Processing~~ | ~~3235-AL96~~ |
| SEC | Proposed Rule Stage | Disclosure of Payments by Resource Extraction Issuers | 3235-AM06 |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Extending the Testing the Waters Provision to Non-Emerging Growth Companies~~ | ~~3235-AM23~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Accelerated Filer Definition~~ | ~~3235-AM41~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Regulation A~~ | ~~3235-AM42~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Exchange-Traded Funds~~ | ~~3235-AJ60~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Enhanced Disclosure for Separate Accounts Registered as Unit Investment Trusts and Offering Variable Insurance Products~~ | ~~3235-AK60~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Use of Derivatives by Registered Investment Companies and Business Development Companies~~ | ~~3235-AL60~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Amendments to the Marketing Rules Under the Advisers Act~~ | ~~3235-AM08~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Fund of Funds Arrangements~~ | ~~3235-AM29~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Offering Reform for Business Development Companies under the Small Business Credit Availability Act and Closed-end Funds under the Economic Growth, Regulatory Relief, and Consumer Protection Act~~ | ~~3235-AM31~~ |
| SEC | Proposed Rule Stage | Transfer Agents | 3235-AL55 |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Harmonization of Certain Title VII Rules~~ | ~~3235-AM13~~ |

| Agency | Agenda Stage of Rulemaking | Title | RIN |
|---|---|---|---|
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Volcker Rule Community Bank Relief and Removing Naming Restrictions~~ | ~~3235-AM43~~ |
| ~~SEC~~ | ~~Proposed Rule Stage~~ | ~~Amendment to Rule for Nationally Recognized Statistical Rating Organizations~~ | ~~3235-AM05~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Disclosure of Hedging by Employees, Officers and Directors~~ | ~~3235-AL49~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Modernization of Property Disclosures for Mining Registrants~~ | ~~3235-AL81~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Disclosure Update and Simplification~~ | ~~3235-AL82~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Amendments to Implement FAST Act Report~~ | ~~3235-AM00~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures to Retail Communications and Restrictions on the use of Certain Names or Titles~~ | ~~3235-AL27~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Amendments to Securities Act Rules Under the Fair Access to Investment Research Act of 2017~~ | ~~3235-AM24~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation~~ | ~~3235-AM36~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Capital Requirements for Broker-Dealers~~ | ~~3235-AL12~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Reporting and Recordkeeping Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants~~ | ~~3235-AL45~~ |
| SEC | Final Rule Stage | Definition of "Covered Clearing Agency" | 3235-AL48 |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Disclosure of Order Handling Information~~ | ~~3235-AL67~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps~~ | ~~3235-AL76~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Transaction Fee Pilot~~ | ~~3235-AM04~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Prohibitions and Restrictions on Proprietary Trading and Certain Relationships With Hedge Funds and Private Equity Funds~~[100] | ~~3235-AM10~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Regulation Best Interest~~ | ~~3235-AM35~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Amendments to Municipal Securities Disclosure~~ | ~~3235-AL97~~ |
| ~~SEC~~ | ~~Final Rule Stage~~ | ~~Auditor Independence With Respect to Loans or Debtor-Creditor Relationships~~ | ~~3235-AM01~~ |

[100] The agencies intend to issue a separate proposed rulemaking addressing and requesting comment on additional covered funds provisions and other fund-related issues.

| Agency | Agenda Stage of Rulemaking | Title | RIN |
|---|---|---|---|
| SEC | Final Rule Stage | Amendments to the Commission's Whistleblower Program Rules | 3235-AM11 |

## RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM JAY CLAYTON

*Updating the Rule on Stock Buybacks*

**Q.1.** Chair Clayton, in some of your recent rule proposals you noted that changes were needed because the rules had not been revised in 20 some years. The rule on stock buybacks was issued in 1982 and has not been meaningfully updated since then.

Do you intend to review Rule 10b–18 given the increase in stock buybacks since 1982, in particular considering the significant amount spent on stock repurchases in the past 2 years? If not, why not?

**A.1.** Response not received in time for publication.

*Executive Stock Buybacks*

**Q.2.** At a Senate hearing last year ago, you said that research that your colleague Commissioner Jackson had issued demonstrating a correlation between the timing of insider share selling and stock buybacks might be a coincidence. Commissioner Jackson subsequently published further research reinforcing his initial findings that executives do often time the sale of their personal equity to take advantage of the price increase created by repurchases and their announcement.

Another study in a working paper for the Roosevelt Institute found a significant relationship between heightened stock buyback activity and insiders selling their own shares. And there are a number of studies showing that stock buybacks are also more likely when a CEO's bonus is directly linked to earnings per share (Lin 2016; Almeida Fos and Kronlund 2016).

Given this research, would you agree that the evidence suggests a finding that this is not merely coincidence? With this growing body of evidence supporting a finding that there may be market manipulation, would you support additional regulations to close the regulatory loophole that makes this legal?

**A.2.** Response not received in time for publication.

*Private Offerings*

**Q.3.** You've stated that you would like to provide Main Street investors with more opportunities to invest in private placements.

In a briefing with Senate staff, the Director of the Division of Corporation Finance said, "Investors are well protected when they invest in public companies." Unfortunately, the implication is that they are not well protected when investing in private companies or offerings. Yet, you proposed rule changes on Dec. 18 that would open private offerings to more Main Street investors without considering investor protection.

Private market investments can be opaque, complex, and risky compared to publicly traded securities. Earlier this year, we saw how WeWork owner We Company canceled its initial public offering after it disclosed significant conflicts and questionable governance practices that raised significant concerns with public market investors. Sophisticated investors that participated in earlier private offerings by the company soon realized they had not been told the whole story. Over subsequent weeks, the company's valuation was slashed and it cut 20 percent of its employees.

Do you think Main Street investors will be able to sufficiently evaluate private offerings and determine when they are not being provided with adequate information, when we have seen billion dollar fund managers taken for a ride?

**A.3.** Response not received in time for publication.

*Proxy Advisor Rules*

**Q.4.** Was it the SEC's intent to make proxy voting advice subject to private actions under Rule 14a–9? If so, would the rule create the threat that issuers and others who disagree with a proxy advisory firm's advice and recommendations may pursue litigation against proxy advisors?

**A.4.** Response not received in time for publication.

**Q.5.** Has, or will, the SEC take any steps to verify the data in Table 2: Registrant Concerns Identified in Additional Definitive Proxy Materials on page 96 of the Proxy Rules proposal?

**A.5.** Response not received in time for publication.

*Shareholder Proposal Revisions*

**Q.6.** The SEC's recent proposal to raise the shareholder vote requirement for shareholder proposal resubmissions not only increases each of the applicable thresholds, but also contains a Momentum Requirement, as explained in the rule proposal.

What is the purpose of the Momentum Requirement, which would allow companies to exclude proposals that have been submitted three or more times in the preceding 5 years if they received more than 25 percent, but less than 50 percent, of the vote and support declined by more than 10 percent from the immediately preceding vote? Would a proposal that receives a 49 percent vote 1 year, but the next year receives a 44 percent vote (a 10 percent decline) be excluded in subsequent years? What do you believe the Momentum Requirement measures and why is it not arbitrary?

**A.6.** Response not received in time for publication.

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## RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM JAY CLAYTON

**Q.1.** I would like to start out by first applauding the SEC, specifically the office of Minority and Women Inclusion. The report from March of this year detailed plans and initiatives in advancing minority and women candidates within the SEC's workforce.

I want to focus on one part of the report which is the issue of developing a pipeline of diverse talent from which the agency can pull from for future talent and employment.

Of note to me was that the word “apprenticeships” was entirely absent from that report. I have long believed that education, and by extent, apprenticeships provide a critical opportunity for individuals to develop the right skills for a job and for an organization to create a pipeline for success.

Please answer the following with specificity:

- Do you agree that education and apprenticeships can be useful to the SEC in attracting and maintaining talent within the agency that you oversee?

**A.1.** Response not received in time for publication.

**Q.2.** The number of black and Hispanic students earning college degrees is growing. This is a good thing. But agencies should be actively seeking these individuals in order to place them in the pipeline that I was referring to before.

Currently, roughly 9 percent of all African American college students attend HBCUs. Many of these schools have begun engaging in partnerships with government agencies to create that pipeline at an early stage.

My bill, the HBCU Partners Act, which passed the Senate in February, would codify the President’s 2017 Executive order on HBCU’s and ask several Federal agencies to strengthen partnerships with HBCUs by leveraging resources and strengthening HBCU capacity and participation.

This is a great way for agencies to recruit and develop the talent and skills of minority candidates.

Please answer the following with specificity:

- While the SEC was not specifically named in the Executive order or the bill, would the agency be open to a developing a program like this for HBCUs?
- Has the agency previously ever taken a look at HBCUs and the potential of students that attend those schools and how they could be beneficial to the SEC?
- Outside of the current outreach initiatives that the SEC is engaging in, what steps are you taking to increase the agency’s outreach to minority candidates in disadvantaged communities?

**A.2.** Response not received in time for publication.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR COTTON FROM JAY CLAYTON**

**Q.1.** As you know, the SROs responsible with access to the CAT database are for-profit entities, and competitors to many of the firms inputting data. As currently designed, they will have access to ALL transaction data reported into the CAT, not just their own.

- How is the SEC ensuring that the SROs do not use CAT data for commercial gain?
- Has the SEC considered limiting access to the transaction data so that SROs could only access data from their own exchanges?
- Along those lines, will the Commission prohibit the SROs from accessing the customer database?

**A.1.** Response not received in time for publication.

**Q.2.** The SROs plan to engage in bulk downloading of CAT data into their own systems, contrary to earlier reporting that a secure analytics environment would be developed to allow the SROs to access the data without bulk downloading. When firms waive claims of liability against the CAT processor, they will effectively also be waiving claims of liability against the SROs that will bulk download their clients' data into their own systems. While the CAT has robust security protocols, there is little to no transparency into the security of the SROs that will have access.

- How is the SEC evaluating the risks associated with the SROs access to the CAT database?
- Will the SEC consider changing this bulk download policy to prohibit the SROs from bulk downloading data?

**A.2.** Response not received in time for publication.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM JAY CLAYTON**

**Q.1.** A tax on financial transactions hinders all investors, especially everyday Americans. Mr. Chairman, do you agree that an FTT would negatively impact everyday savers, increasing costs and lowering returns? Are there also market and liquidity risks we should keep in mind?

**A.1.** Response not received in time for publication.

**Q.2.** It is my understanding that audit quality is improving and a key indicator is the fact that the number of restatements to public company financial statements has significantly declined since the passage of Sarbanes Oxley. Currently the number of restatements is at an 18-year low, and not only has the number dropped but the magnitude has also declined. Would you agree that audit quality continues to improve since the passage of Sarbanes-Oxley?

**A.2.** Response not received in time for publication.

**Q.3.** Companies don't choose stock buybacks over reinvesting in the company. I believe businesses make the most productive decisions they can based on the capital they have. In fact, S&P 500 firms have increased their R&D and capital expenditures as a percentage of revenue over recent years, and R&D spending is at a record high. There is a common misperception out there that stock buybacks exclusively benefit company executives and the wealthy. I believe they benefit everyday Americans and retirement account holders. Opponents of buybacks and this free-flow of capital that has created the greatest economy in the world have suggested repealing the Commission's Rule 10b–18. What would be the impact on companies' ability to buy their stock of repealing Rule 10b–18? What would be the impact on capital formation and business investment? Is the repeal of Rule 10b–18 something you or others at the Commission are currently considering?

**A.3.** Response not received in time for publication.

**Q.4.** Chairman Clayton, I appreciate your work to encourage more U.S. public companies. One area I hope you can review as part of your larger efforts is the current definition of venture capital fund for purposes of fund registration. My State of North Carolina is home to a significant number of biotechnology startups who often go public before their product is commercialized. After going public, these companies may need to go back to their major investors, such as venture capital funds, for additional capital infusions to fund clinical trials and other needs. Unfortunately, because the current definition of venture capital fund considers any investment in a company once it goes public to be nonqualifying, it makes it more difficult for VC funds to participate in these critical financings, though they are the most likely pools of capital to meet these needs. This creates a potential penalty to going public, and while unintentional is nonetheless impactful. Can you commit to reviewing this issue and provide me an update on whether the SEC would be willing to remove this barrier?

**A.4.** Response not received in time for publication.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR KENNEDY FROM JAY CLAYTON**

**Q.1.** How much will the CAT cost to set up? How much has been spent to date?

**A.1.** Response not received in time for publication.

**Q.2.** How much will the CAT cost to maintain annually?

**A.2.** Response not received in time for publication.

**Q.3.** How will the CAT prevent the next flash crash?

**A.3.** Response not received in time for publication.

**Q.4.** How will the CAT prevent market manipulation?

**A.4.** Response not received in time for publication.

**Q.5.** What will the CAT provide that the current blue sheets process does not?

**A.5.** Response not received in time for publication.

**Q.6.** Has the agency considered an expedited blue sheets process in lieu of the CAT? Please explain.

**A.6.** Response not received in time for publication.

**Q.7.** Is response time the greatest concern when investigating concerning trends or behavior?

**A.7.** Response not received in time for publication.

**Q.8.** The SROs plan to engage in bulk downloading of CAT data into their own systems, contrary to earlier reporting that a secure analytics environment would be developed to allow the SROs to access the data without bulk downloading. When firms waive claims of liability against the CAT processor, they will effectively also be waiving claims of liability against the SROs that will bulk download their clients' data into their own systems. While the CAT has robust security protocols, there is little to no transparency into the security of the SROs that will have access. Several of my colleagues and I wrote you a letter on the subject.

How is the SEC evaluating the risks associated with the SROs access to the CAT database?

**A.8.** Response not received in time for publication.

**Q.9.** Will the SEC consider changing this bulk download policy to prohibit the SROs from bulk downloading data?

At the Senate Banking Committee's October 22 hearing on Oversight of the Status of the Consolidated Audit Trail, Michael Simon stated, "It would be great from a customer protection and confidence and integrity standpoint to be able to integrate the U.S. futures markets into the consolidated audit trail as well, and potentially at some point, the non-U.S. markets since we are in a global market, both in respect to products and with respect to geography."

**A.9.** Response not received in time for publication.

**Q.10.** Has the agency discussed internally or have there been any interagency conversations on expanding the scope of the CAT to additional U.S. markets?

**A.10.** Response not received in time for publication.

**Q.11.** Has there been any discussions with any international counterparts to expand the scope of the CAT to the global market?

**A.11.** Response not received in time for publication.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR MORAN FROM JAY CLAYTON**

**Q.1.** The U.S. capital markets have a strong and multi-layered system for surveillance and regulation. The SEC is obviously key and FINRA plays a role—although some exchanges are scaling-back their use of FINRA. Is this correct?

**A.1.** Response not received in time for publication.

**Q.2.** It is often overlooked that the actual equities and options exchanges bring considerable expertise, technology and understanding to the regulatory role. They are the closest "cop on the beat" to the trading activity on each of their respective markets. No matter their relationship with FINRA, the exchanges still retain the full obligation for regulating their markets. Our exchanges have among the best technological regulatory systems in the world and are a full partner to the SEC. Do you agree?

**A.2.** Response not received in time for publication.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM JAY CLAYTON**

**Q.1.** Commissioner Clayton, when I asked you about the SEC's ability to independently verify the information in Section 13D filing, or to verify whether a foreign entity should have filed a 13D, but failed to comply with the law, you said you were looking for ways to enhance the SEC's ability to do so.

- Can you please share what steps you have taken to enhance the SEC's ability to investigate and enforce Section 13D violations?
- What further steps do you plan on taking to enhance the SEC's ability in this area?
- Are there any statutory impediments hampering the SEC from investigating or enforcing 13D violations?

- You also suggested that the SEC's enforcement division monitors Section 13D violations by sector. Could you share with the Committee the sectors that the SEC has found to have the most frequent 13D violations?
- When you do find a suspected 13D violation, how does the SEC enforce the law and what penalties are assessed against persons or entities found to have broken the law?

**A.1.** Response not received in time for publication.

**Q.2.** While appropriate short selling can support stable, liquid markets, the current lack of transparency around short positions deprives investors, companies, and the market of valuable information. It may also enable trading behaviors that unfairly harm small, growing companies and their investors.

- What are your thoughts on the current lack of transparency with regard to short positions?
- How do you believe the SEC can act to ensure an equitable disclosure regime for short and long investors?

**A.2.** Response not received in time for publication.

**Q.3.** Earlier this year, Comptroller Otting said that the OCC was taking the lead on writing a rule to rein in risky incentive-based compensation practices at large financial institutions that reward senior bank executives for irresponsible risk-taking. Additionally, at a House Financial Services Committee hearing in May, Otting said that he shared his proposal with the SEC.

- Has Comptroller Otting shared the OCC's proposal with the SEC? If so, please provide details of the proposal and a timeline of when Congress can expect see a notice of proposed rulemaking posted.
- Section 956 of Dodd-Frank requires the OCC, the Federal Reserve, FDIC, NCUA, FHFA, and the SEC to jointly propose an executive compensation rule to prohibit unsafe and unsound compensation plans. Have all six regulators sat down together to discuss this rulemaking? If so, have all six regulators decided to move forward with the proposed rule?
- Section 956(b) mandates that regulators "prohibit any types of incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages inappropriate risks." Can you commit to me the final rule will live up to the intent of Congress?

**A.3.** Response not received in time for publication.

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## RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNER FROM JAY CLAYTON

*Data Security*

By many accounts, one of the top risks to companies and organizations today is data security. One way to mitigate against such risks is to only collect information that the SEC needs and to have policies in place that seek to protect it.

**Q.1.** Does the SEC have agency-wide existing policies, specifically for highly sensitive and proprietary information like investment strategies, trade secrets, and related intellectual property, that govern when this information can be requested, where and who at the agency can review it, and how it is stored or returned?

**A.1.** Response not received in time for publication.

**Q.2.** What steps can be taken to ensure that Commission staff today or in the future request highly sensitive and proprietary information, like trade secrets and related intellectual property, from registrants only when it is necessary?

**A.2.** Response not received in time for publication.

*Pricing Tiers*

Chairman Clayton, on May 21, 2019, the Commission staff released SRO Fee Guidance, which, inter alia, reiterates the Commission staff's obligations to ensure that fees charged by exchanges are "reasonable," "equitably allocated," not undue burdens on competition, and not discriminatory. That guidance applies to both market data-related fees and transaction fees. While I have seen a lot of Commission scrutiny and actions on market data fees, and I was encouraged when the Commission announced the transaction fee pilot in 2018, I was disappointed that the pilot was put on hold, and since then I have not seen the Commission scrutinize or take any actions related to transaction fees and rebates. It is my understanding that there are now hundreds of different transaction prices offered by various market centers, and that exchanges may file for pricing tier changes that seem so specific that they are likely to be privately negotiated with and apply to a single market participant.

**Q.3.** Are you worried about the disparate competitive impact of these transaction pricing tiers on brokers and other market participants?

**A.3.** Response not received in time for publication.

**Q.4.** I understand that there's a lot of water under the bridge on past transaction fees and rebates, but will you commit to ensuring that exchange pricing tiers going forward are not discriminatory, not undue burdens on competition, reasonable, and equitably allocated?

**A.4.** Response not received in time for publication.

**Q.5.** Institutional investors don't usually know the different pricing tiers their brokers receive. So they may not know that their broker might get a 20 percent larger rebate for an order to one exchange as opposed to another. And yet that financial difference for the broker may have a profound impact on where the broker routes that investor's order. Will the broker route to the exchange that makes the broker more money, or where it is best for the investor? Will you commit to expanding transparency into the number and impact of pricing tiers offered by exchanges and how many participants hit each tier?

**A.5.** Response not received in time for publication.

*Competition and Consolidation*

The top 10 global asset managers now control about ⅓ of the managed assets in the world. The banking industry is also increasingly concentrated at the top. The biggest firms are getting bigger, and I'm worried we're losing competition in our industry. We need a deep bench of diverse managers and brokers out there. The rules and guidance you adopt at the Commission have profound impacts on that competition between firms. For example, by permitting exchange transaction fees that discriminate against smaller players, the SEC is expressly granting a massive competitive trading advantage to larger players. Similarly, by taking the approach it has with MiFID II, smaller advisers may be squeezed to pay for investment research directly, leading to even further consolidation for both advisers and brokers.

Last month, you gave a speech in which you said that you would "defer to [Assistant Attorney General for the Antitrust Division Makan Delrahim and FTC Chairman Joe Simons] on antitrust policy and enforcement." But, as Commissioner Jackson has recently highlighted, the Federal securities laws that the SEC is tasked with overseeing clearly put "competition" as one of your responsibilities. I am worried that the crucial issues of competition and antitrust in the context of the securities markets do not fall in an administrative black hole.

**Q.6.** Will you commit to retaining experts to advise you on the impacts of Commission action or inaction on competition between market participants, with a particular focus on disparate impacts on smaller firms?

**A.6.** Response not received in time for publication.

*Market Data*

We live in a world where technology has brought down the cost of nearly everything we buy, yet the distribution of data, which is inherently a technology powered service continues to rise.

**Q.7.** Will you commit to examining and reporting to Congress on the costs to the exchanges of producing market data and offering connectivity services?

**A.7.** Response not received in time for publication.

*Immediately Effective Filings*

Section 916 of the Dodd-Frank Act permits exchanges to file changes to their market data and transaction fees, and then immediately begin charging market participants the new rates. While well intentioned, this change has also created some notable abuses.

**Q.8.** I understand that at least one exchange has repeatedly charged customers for fees that have been stopped by the Commission staff and even the Commission itself. Can you please detail how you will ensure that market participants are not subjected to market data or transaction fees that are inconsistent with the Exchange Act or Commission Rules?

**A.8.** Response not received in time for publication.

**Q.9.** Transaction fees paid by customers are now quite often changed literally overnight. That means market participants all over the industry may have to (1) identify, (2) understand, and (3) implement the changes without any prior notice. This challenges the industry's ability to route orders in a manner consistent with best execution if they cannot be confident they have a current understanding of costs. What can you do to make sure that all market participants have adequate notice of these types of changes?

**A.9.** Response not received in time for publication.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM JAY CLAYTON**

*Leveraged Lending*

**Q.1.** In November 2018, I sent a letter to you, Treasury Secretary Steven Mnuchin, Federal Reserve Chairman Jerome Powell, Comptroller of the Currency Joseph Otting, and Federal Deposit Insurance Corporation Chairman Jelena McWilliams expressing concern about the rapid growth of leveraged corporate lending, or lending to companies that are already highly indebted.[1]

In a section addressed to you, I stated that the Volker Rule is intended to restrict bank involvement with external funds and that trade associations have asked you to significantly loosen Volcker Rule controls. The SEC completed its rollbacks of the Volcker Rule in September.[2] In response to the rollback of the Volcker Rule, SEC Commissioner Robert J. Jackson, Jr., stated, "as I said at the proposal stage, '[r]olling back the Volcker Rule while failing to address pay practices that allow bankers to profit from proprietary trading puts American investors, taxpayers, and markets at risk.'"[3]

- Your January response provided a procedural, but not a substantive, explanation of the status of SEC's proposed amendments to the Volcker Rule. Please explain the SEC's rationale for removing protections against excessive risks under the Volcker Rule.
- Commissioner Jackson also stated, "The Commission has justified the rollback of the significant investor- and taxpayer-protections in the Volcker Rule in the name of needed improvements in 'liquidity and capital formation.' Because the facts and our own Staff's analysis offer no meaningful evidence that the Volcker Rule has affected either, I respectfully dissent."[4] Please describe any evidence that the amendments rolling back the Volcker Rule are beneficial to the safety and security of securities markets.

**A.1.** Response not received in time for publication.

*Inflated Bond Ratings*

**Q.2.** In September, I wrote you a letter regarding troubling reports of inflated bond ratings and the perverse incentives within the bond rating industry and urged the SEC to take immediate action

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[1] Letter from Senator Warren to Treasury Secretary Steven Mnuchin, Federal Reserve Chairman Jerome Powell, Comptroller of the Currency Joseph Otting, Securities and Exchange Commission Chairman Jay Clayton, and Federal Deposit Insurance Corporation Chairman Jelena McWilliams, November 14, 2018, *https://www.warren.senate.gov/imo/media/doc/2018.11.14%20Letter%20to%20Regulators%20on%20Leveraged%20Lending.pdf.*

[2] U.S. Securities and Exchange Commission, "Statement on Volcker Rule Amendments," Public Statement by Commissioner Robert J. Jackson Jr., September 19, 2019, *https://www.sec.gov/news/public-statement/statement-jackson-091919.*

[3] *Id.*

[4] *Id.*

to protect the economy from risky lending propped up by conflicts of interest between bond issuers and rating agencies.

My letter described the flows in the incentive structures of bond-ratings firms' through the "issuer-pays" model used by major firms like S&P and Moody's. Under the issuer-pays model, bond issuers pay the agencies for their assessments of the products they hope to sell, ultimately giving the rating firms an incentive to give better ratings, regardless of the risk, since bond issuers might otherwise go to their competitors.[5] In your November response, you stated that you share my concerns about conflicts of interest in rating agency compensation models and said that you are awaiting recommendations or advice from various advisory committees.[6]

- Have you instructed the advisory committees that the SEC is consulting for recommendations or advice on the role and activities of bond rating agencies to produce any work products by a certain date or timeline? If so, please explain your instructions and any requested deadlines. Additionally, please explain if these recommendations or advice will be made public.
- Please describe any updates from the advisory committees that the SEC is consulting for recommendations or advice regarding the role and activities of bond rating agencies. Please describe any communications you, or other senior SEC staff, have had with these advisory committees regarding any anticipated timelines or deadlines for their conclusions.
- Your response also referenced some work that the SEC has done to respond to the conflicts of interest in the issuer-pays model.[7] An August Wall Street Journal report, however, stated that "Inflated bond ratings were one cause of the financial crisis. A decade later, there is evidence they persist. In the hottest parts of the booming bond market, S&P and its competitors are giving increasingly optimistic ratings as they fight for market share."[8] Please explain why the SEC's efforts to respond to the conflicts of interest have failed to prevent bond rating agencies from artificially inflating bond ratings.
- Your November response also stated, "I expect to continue to discuss issues related to the [collateralized loan obligations], other credit funds and conditions in the credit markets more generally in the near term with my national and international regulatory colleagues, including through the [Financial Stability Oversight Council] and the [Financial Stability Board]. I will also request our staff in [the SEC Office of Credit Ratings], as well as staff in the Division of Investment Management and Division of Trading and Markets, to keep the issues

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[5] Council on Foreign Relations, "The Credit Rating Controversy," CFR Staff, February 19, 2015, *https://www.cfr.org/backgrounder/credit-rating-controversy.*

[6] Letter from Securities and Exchange Commission Chairman Jay Clayton to Senator Warren, November 21, 2019.

[7] *Id.*

[8] Wall Street Journal, "Inflated Bond Ratings Helped Spur the Financial Crisis. They're Back," Cezary Podkul and Gunjan Banerji, August 7, 2019, *https://www.wsj.com/articles/inflated-bond-ratings-helped-spur-the-financial-crisis-theyre-back-11565194951.*

you raised in your letter in mind as they carry out their examination and other responsibilities."[9]

- Please describe your near-term discussions with national and international regulatory colleagues, as referenced in your response.
- Please describe your communications, including all directives, with SEC staff regarding the issues raised in my letter, as referenced in your response.

**A.2.** Response not received in time for publication.

*Regulation Best Interest (Reg BI)*

**Q.3.** In June 2019, SEC approved Reg BI, which despite Congress's instruction in sections 913(f) and 913(g) of Dodd-Frank establishes neither a uniform standard for broker-dealers and investment advisers, nor a fiduciary standard for broker-dealers.[10] SEC Commissioner Robert J. Jackson, Jr., described the rule as "a muddled standard that exposes millions of Americans to the costs of conflicted advice."[11]

**Q.3.a.** Reg BI includes no obligation to eliminate conflicts of interest—the SEC clearly stated, "we are not requiring broker-dealers to develop policies and procedures to disclose and mitigate all conflicts of interest."[12] Instead, Reg BI imposes a limited requirement to disclose conflicts.

Following the SEC's adoption of Reg BI, Commissioner Jackson stated, "in analysis released by my Office today, we show that advisers who use the language in today's release are much more likely to offer conflicted advice. And a well-known study shows that conflicted advice is the kind that leads to fraud that can hurt investors."[13]

- Consumers and investors are drowning in disclosures that are hard to understand. What evidence does that SEC have that limited the disclosures required by the rule in practice would not reduce both conflicts of interest fraud.
- Please explain why the SEC did not provide a definition of the term "best interest," which is the central concept that defines the duty imposed on broker-dealers.

**A.3.a.** Response not received in time for publication.

**Q.3.b.** The Department of Labor is considering a replacement of its Fiduciary Rule with standards of conduct that would allow advisers providing advice regarding retirement investments to engage in conflicts of interest that harm working families saving for retire-

[9] Letter from Securities and Exchange Commission Chairman Jay Clayton to Senator Warren, November 21, 2019.

[10] U.S. Securities and Exchange Commission, "SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Financial Professionals," press release, June 5, 2019, *https://www.sec.gov/news/press-release/2019-89.*

[11] U.S. Securities and Exchange Commission, "Statement on Final Rules Governing Investment Advice," Public Statement by Commissioner Robert J. Jackson Jr., June 5, 2018, *https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd.*

[12] U.S. Securities and Exchange Commission, Federal Register Final Rule, "Regulation Best Interest: The Broker-Dealer Standard of Conduct," July 12, 2019, pp. 33388, *https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12164.pdf.*

[13] U.S. Securities and Exchange Commission, "Statement on Final Rules Governing Investment Advice," Public Statement by Commissioner Robert J. Jackson Jr., June 5, 2018, *https://www.sec.gov/news/public-statement/statement-jackson-060519-iabd.*

ment. I am concerned that the Labor Department will simply adopt, or largely base its new rules on, Reg BI, as then-Secretary Alex Acosta stated that the department was "communicating with [the SEC], and based on our collaborative work we will be issuing new rules in this area."[14]

- Please describe any communications or guidance that you, or other senior SEC leadership, have had with then-Secretary Acosta, Secretary Scalia, or other Labor Department officials, regarding the Labor Department's Fiduciary Rule or the SEC's Reg BI.

**A.3.b.** Response not received in time for publication.

*Climate Risk Disclosure*

**Q.4.** In July, Representative Sean Casten (D–IL–06) and I introduced H.R. 3623/S. 2017, the Climate Risk Disclosure Act of 2019.[15] Our bill would address the fact that investors currently lack access to basic information about the potential impact of the climate crisis on American companies, which creates significant environmental and financial risks. The Climate Risk Disclosure Act of 2019 would require public companies to include uniform information about their exposure to climate-related risks, which will help investors appropriately assess those risks, among other benefits, in their disclosures to the SEC.

**Q.4.a.** The most recent volume of the National Climate Assessment, a scientific report issued by 13 Federal agencies in November 2018, stated that climate change may cause losses of up to 10 percent of the U.S. economy by 2100.[16] Additionally, a 2015 report from The Economist Intelligence Unit wrote that, of the world's current stock of manageable assets, the expected losses due to climate change are valued at $4.2 trillion by the end of the century.[17]

- Do you believe that understanding which assets of public companies may be materially affected by climate change may help investors make more informed decisions about the risk of their investments?
- Do you believe it would be useful for investors to understand public companies' contributions to greenhouse gas emissions and their exposure in the event of a Government- or market-mandated transition toward a lower-carbon economy?

**A.4.a.** Response not received in time for publication.

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[14] House Committee on Education and Labor, "Examining the Policies and Priorities of the U.S. Department of Labor," May 1, 2019, *https://edlabor.house.gov/hearings/04/24/2019/examining-the-policies-and-priorities-of-the-us-department-of-labor.*

[15] Office of Senator Warren, "Senator Warren, Representative Casten Lead Colleagues Introducing a Bill to Require Every Public Company to Disclose Climate-Related Risks," press release, July 10, 2019, *https://www.warren.senate.gov/newsroom/press-releases/senator-warren-representative-casten-lead-colleagues-introducing-a-bill-to-require-every-public-company-to-disclose-climate-related-risks.*

[16] Office of Senator Warren, "Senator Warren, Representative Casten Lead Colleagues Introducing a Bill to Require Every Public Company to Disclose Climate-Related Risks," press release, July 10, 2019, *https://www.warren.senate.gov/newsroom/press-releases/senator-warren-representative-casten-lead-colleagues-introducing-a-bill-to-require-every-public-company-to-disclose-climate-related-risks.*

[17] Office of Senator Warren, "Senator Warren, Representative Casten Lead Colleagues Introducing a Bill to Require Every Public Company to Disclose Climate-Related Risks," press release, July 10, 2019, *https://www.warren.senate.gov/newsroom/press-releases/senator-warren-representative-casten-lead-colleagues-introducing-a-bill-to-require-every-public-company-to-disclose-climate-related-risks.*

**Q.4.b.** A Government Accountability Office (GAO) report from February 2018 states, "[Securities and Exchange Commission (SEC)] reviewers may not have access to the detailed information that companies use to arrive at their determination of whether risks, including climate-related risks, must be disclosed in their SEC filings."[18] While the SEC has issued guidance for considering effects of climate change, the SEC has not mandated disclosures for how climate risk materially affects returns.

- If Federal regulators do not have the information needed to fully understand public companies' climate-related risks under current law, do investors have the adequate information needed to make informed decisions about companies' risks?

**A.4.b.** Response not received in time for publication.

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**RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM JAY CLAYTON**

**Q.1.** Over the summer, the SEC held a day-long review to consider proxy advisor issues. The consensus position was that voting participation by shareholders was too low. Additionally, there were problems with inaccurate voting.

- What is the SEC doing to increase voting participation by shareholders?
- How is the SEC ensuring votes are accurately tabulated?
- When a teachers' pension fund or investment firm hires a proxy advisory firm to advise the pension fund on shareholder proposals regarding issues such as selecting board members, voting on CEO pay, and considering environmental and governance issues, why should the corporation get to review the report before the firm that paid for it even sees it?
- Why should the proxy advisory firm be required to include statements from corporations that they did not write or request?

**A.1.** Response not received in time for publication.

**Q.2.** I am very skeptical of some of the letters that were submitted to the SEC in support of the proxy advisors rule. It seems that dozens of these letters are fraudulent. Before moving ahead on this rule, I recommend you investigate the validity of the letters.

- Will you wait until after the report of the Inspector General on the validity of the comment letters before proposing a rule?
- How will you ensure that those who hire proxy advisory firms are clearly heard?
- Do you believe that some of these letters do not accurately reflect the views of the signators? If so, what percentage do you think were not accurately submitted? How do you think these inaccurate letters were drafted and submitted?

**A.2.** Response not received in time for publication.

[18] Office of Senator Warren, "Senator Warren, Representative Casten Lead Colleagues Introducing a Bill to Require Every Public Company to Disclose Climate-Related Risks," press release, July 10, 2019, *https://www.warren.senate.gov/newsroom/press-releases/senator-warren-representative-casten-lead-colleagues-introducing-a-bill-to-require-every-public-company-to-disclose-climate-related-risks.*

**Q.3.** Shareholder proposals are an important element of our capital markets. Shareholder democracy creates long-run value for ordinary American investors and holds executives accountable. Commissioner Jackson's research found that your proposed rule on shareholder proposals would remove key CEO accountability matters from the ballot. His research found that proxy-access proposals—initiatives to allow significant shareholders to put their own candidates up for election to the board—would remove 40 percent of these proposals after three tries. He also found that the proposed rule would remove more than half of shareholder proposals that limit CEOs from selling stock they receive as compensation at certain times.

- Why is the SEC considering both raising the thresholds and imposing a tax on anti-management advice at the same time?
- How will you understand the impact if you are overturning decades of proxy advisor practices?
- What percentage of shareholder proposals would have been excluded in recent history—3 years for example—under these proposed rules?

**A.3.** Response not received in time for publication.

**Q.4.** The SEC's disclosure rules have not kept up with the pace of today's markets. Corporate insiders often trade during the "gap" between key business events and when the SEC rules require that event to be revealed to the public.

- What can the SEC do to prevent insiders from selling stock and cashing out during buybacks?
- Can the SEC close that gap on its own or is legislation needed?

**A.4.** Response not received in time for publication.

**Q.5.** What is your timeline for any proposed changes to the definition of "accredited investors?"

**A.5.** Response not received in time for publication.

**Q.6.** In September 2019, attorneys general of seven States and the District of Columbia and XY Planning Network, a coalition of fee-only financial planners, each sued the SEC for creating an unfair competitive advantage for broker-dealers with Regulation Best Interest. The States' complaint asserts that Regulation Best Interest "undermines critical consumer protections for retail investors." They say that Regulation Best Interest increases confusion about the standards of conduct that apply when investors receive recommendations and advice from broker-dealers or investment advisers.

How many broker-dealers registered as investment advisers because of this rule change?

**A.6.** Response not received in time for publication.

**Q.7.** The Supreme Court's June 2017 decision in Kokesh v. SEC limited the SEC's ability to make firms repay ill-gotten gains from certain long-running frauds.

- Please explain why the Supreme Court's decision preventing the SEC from obtaining disgorgement cost the agency $900 million in fiscal year 2018 alone and what it will mean going forward.

- Some fraud takes place over years and may takes years to uncover. Should we have any restrictions on how long ago the fraud occurred or was discovered in order to compensate victims?
- FINRA and the SEC can detect possible suspicious trading almost the moment that it takes place. They have well-monitored public markets that allow such oversight allowing insider trading and market manipulation to be prosecuted significantly more quickly. Should regulators take types of fraud into account with determining the statute of limitations on disgorgement?

**A.7.** Response not received in time for publication.

**Q.8.** What is your timeframe for responding to FINRA's proposed rule 4111?

**A.8.** Response not received in time for publication.

**Q.9.** There have been concerns about publicly traded companies fixing accounting errors without restating earnings on a "Big R" restatement form. Does allowing companies to reissue financial statements with significant changes under "Little r" harm investors by allowing firms to hide material errors? How important are "clawbacks" in allowing executives to avoid having their compensation recouped by filing a Little r instead of a Big R?

**A.9.** Response not received in time for publication.

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**RESPONSE TO WRITTEN QUESTION OF SENATOR SINEMA FROM JAY CLAYTON**

**Q.1.** What measures are the SEC taking to ensure Regulation Best Interest adequately protects Arizonans' retirement security as industry moves toward a June 2020 compliance deadline?

**A.1.** Response not received in time for publication.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

BETTER MARKETS

December 10, 2019

The Honorable Michael Crapo
Chairman, Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member, Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

Better Markets[1] appreciates the opportunity to share our perspectives on the activities of the U.S. Securities and Exchange Commission (SEC) as part of the Senate Banking Committee's oversight hearing. We write to provide the Committee with our perspective on a few key issues confronting the SEC as it serves as our nation's primary regulator of the securities markets.

**SEC's "Regulation Best Interest"**

The SEC's primary obligation is to protect investors, not brokers' products or their lucrative business models. Unfortunately, the Commission's recently adopted "Regulation Best Interest" fails to meet that obligation. Tens of millions of American investors and retirees lose tens of billions of dollars a year to brokers and other financial advisers who have very powerful conflicts of interest. The result is that too many of them put their own economic interests ahead of those of their clients.

While a straightforward fiduciary duty rule requiring those brokers and financial advisers to put their clients' best interest first when giving investment advice would eliminate this incredibly unfair and costly behavior, the SEC unfortunately caved in the face of massive industry opposition and instead approved a so-called "Regulation Best Interest." Unfortunately, the proposal is woefully inadequate and will make things worse for hardworking Main Street investors and retirees by misleading them into thinking they're receiving protections that don't really exist. Among other problems, the SEC's proposal never defines "best interest," instead, creating a "check-three-boxes" test that brokers can use to comply with the rule and avoid accountability—even though none of the boxes actually require brokers to act in the best interest of their clients.[2]

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street and make our financial system work for all Americans again. Better Markets works with allies – including many in finance – to promote pro-market, pro-business and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements and more.

[2] For details on the many deficiencies of Reg BI, please review our materials here: https://bettermarkets.com/newsroom/fact-sheet-secs-upcoming-vote-its-so-called-best-interest-proposed-rule

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The economic analysis of investor harm in the proposal was so deficient that eleven former lead economists for the SEC took the unprecedented step of writing to the agency highlighting the glaring deficiencies in the analysis.[3] The SEC relies far too much on the broker's purported disclosure of conflicts of interest to protect investors and retirees. Yet, many studies – and the SEC's own expert staff – have known for years that disclosure alone cannot protect investors from conflicts of interest, any more than disclosure can protect Americans from contaminated pharmaceuticals, polluted water or spoiled food on the grocery store shelf. Only strong, clear and enforceable standards of conduct will protect Americans from the grave threats to their savings and retirements from the irresistible riches available to brokers and advisors as a result of these permitted conflicts of interest. We encourage the Committee to conduct vigorous oversight of the SEC's implementation, interpretation and enforcement of the so-called "Regulation Best Interest."

**Consolidated Audit Trail**

More than nine years after the trillion dollar "Flash Crash," the SEC's completion and implementation of the Consolidated Audit Trail (CAT) is an utter failure. It is important to acknowledge that Chairman Clayton inherited a suboptimal situation not of his making or desire when he took the leadership of the SEC; it is also important to note that he has admirable taken several positive actions in the face of fierce albeit baseless industry opposition. However, it remains true that the failure to get this mission-critical investor protection system up and running needlessly and irresponsibly places investors, markets and the financial system at grave risk.

An effective and functioning CAT system would revolutionize the SEC's capabilities to protect investors and promote fair and orderly capital markets. When completed, it will be the world's largest data repository for securities transactions, tracking billions of orders, executions, and quotes in all of the equities and options markets every day. That information will enable the SEC not only to reduce, manage, and better understand market disruptions and crashes, but also to identify, deter, and punish illegal manipulations and other trading abuses – all for the benefit of investors and our markets. The importance of this capability simply cannot be overstated.

But although CAT was supposed to be operating no later than November 15, 2017, it is still paralyzed by the conflicted industry-group governance structure which is unwilling to commit to critical decisions that would bring CAT online. Outsourcing this critical stability and investor protection tool to a conflicted industry which it would then police was a near-fatal flaw. Without unwavering leadership from the SEC and the full support and encouragement of the Committee, the CAT will never spring to life. The Committee simply must engage in aggressive oversight of the SEC's implementation of CAT, particularly in the next few months as the Commission is considering amendments to the SEC Rule that created the CAT. Any changes to Rule 613 must include significant improvements to the governance and control of the CAT Operating Committee, as we have detailed on numerous occasions. We further encourage the SEC to use the statutory authority it presently has to hold industry groups accountable for their delay in bringing the system online.

[3] https://www.sec.gov/comments/s7-07-18/s70718-4895197-177769.pdf

**Transaction Fee Pilot Project**

Today's securities markets are too often rigged by insiders to enrich themselves at the expense of the hardworking Main Street investors. To test that proposition, to collect data to determine the extent of anti-investor conduct in the markets, and to have data-informed remedies, in 2018, the SEC released for comment a long-considered, thoughtful, and balanced Proposal to conduct a pilot program by lowering some access fee caps and prohibiting rebates or other economic inducements offered by the exchanges. Better Markets strongly supported this effort, because payments by the exchanges that incentivize and induce routing decisions by broker-dealers at the expense of best execution and market quality is one of those most entrenched and insidious market practices today.[4]

Unfortunately, the large exchanges that take advantage of the current broken system that is harmful to investors and the integrity of the markets, have sued the SEC to stop the Pilot.[5] The Committee should support the Pilot and help the SEC to promptly finalize and implement it. Tens of millions of investors are harmed by current market practices that rely heavily on access fees and rebates and the Committee would be well-served by oversight of these practices and the remedies for them.

**Clawbacks and Incentive-Based Compensation**

Compensation policies that encouraged high-risk behavior were major contributors to the financial crisis of 2008. The report of the House Financial Services Committee on the "Corporate and Financial Institution Compensation Fairness Act of 2009," which was a precursor to the executive compensation provisions in the Dodd-Frank Act, observed that as the financial crisis has unfolded, "a broad consensus has developed that executive and financial institution compensation structures relate directly to both the safety and soundness of individual financial institutions and the health of the broader financial system."[6]

And yet, regulators have failed to act with speed and seriousness of purpose in addressing the flawed incentive-based compensation policies that can pose a threat not only to the long term health of individual financial institutions, but also to the long-term health of the U.S. economy. For example, in the Dodd-Frank Act, Congress enacted a number of measures aimed at correcting the structural flaws in the traditional approach to executive compensation. Those measures include shareholder votes on executive compensation, new listing standards to ensure that compensation committees and their consultants at public companies are independent from management, mandatory disclosure of executive compensation in relation to corporate performance, recovery of erroneously awarded compensation, and limitations on incentive-based compensation arrangements that could encourage inappropriate risks or that could lead to a material financial loss.[7]

Consider the SEC's delay in implementing rules regarding recovering erroneously awarded compensation. As required by the Dodd-Frank Act, the SEC must adopt a rule directing the securities exchanges to establish issuer listing standards providing for the recovery of incentive-based compensation paid to executives in excess of what those executives should have received, as shown by

[4] https://bettermarkets.com/rulemaking/better-markets-comment-letter-transaction-fee-pilot-nms-stocks
[5] https://bettermarkets.com/resources/court-filing-sec-attempts-protect-investors-and-market-integrity-exposing-exchange-pricing
[6] H.R. REP. NO. 111-236, 111th Cong., 1st Sess., at 6 (2009)
[7] Dodd-Frank Act §§ 951-957.

an accounting restatement. This is intended to address the tendency of some corporate executives to engage in accounting fraud or manipulation to justify inflated compensation awards. And while the SEC has implemented many of the Dodd-Frank reforms, progress on the so-called clawback provisions has remained stalled.

It should not take nearly a decade for the SEC to write rules to recovery money from executives who were paid bonuses to which they were never entitled. We encourage Congress to make 2019 the year that the SEC is held to account for its delay in implementing this common-sense rulemaking. These compensation rules have to meaningfully deter and punish those who obtain compensation in violation of the law, and not be riddled with loopholes that render the rules ineffective, as reports suggest industry has been seeking.[8]

**High Risk Broker Firms**

The Financial Industry Regulatory Authority (FINRA) is the self-regulatory organization that oversees the broker-dealer industry. The SEC oversees FINRA and approves its rules, and SEC rules require broker-dealer firms to be members of FINRA. FINRA has the responsibility of writing and enforcing the rules that broker-dealers and registered brokers have to follow in the United States.

FINRA recently proposed a new rule that, after a convoluted and lengthy process, may require firms with a long-history of misconduct to set aside some funds that can be used to reimburse future harmed investors who win arbitration settlements. The rule would apply to firms that have a history of misconduct and specialize in hiring of recidivist brokers — those with 3, 4, 5 or more disciplinary infractions on their record for ripping off their customers or deceiving investors. Many FINRA members have several of these recidivist brokers on their payroll, and both the firms and the rule-breaking brokers they employ have a de facto business model that appears based on maximizing profits by targeting and ripping off unsuspecting, vulnerable and often elderly investors, breaking rules set up by FINRA, the SEC, and other regulators. What FINRA is proposing will not meet the enormous challenges today's investors face and the protections they need.

Investors deserve concrete, effective, and swift action from FINRA against brokers that repeatedly violate FINRA's rules, and the firms that employ them, not convoluted and weak attempts at regulation. Instead, FINRA chooses to do the bare minimum by proposing to make it marginally more expensive for the worst-of-the-worst broker-dealer firms, that have already proven that they will brazenly disregard FINRA rules, to continue hiring and rewarding brokers that give self-serving advice and sell unsuitable products that are harmful for investors' and their families' financial health.

We appreciate the leadership shown by many members of the Committee on this matter and we urge the Committee to conduct oversight of FINRA's lack of sufficient and effective efforts in expelling and barring recidivist broker firms. We also call upon the Committee to ensure that the SEC will only approve FINRA rules that effectively deal with the enormous problem of recidivist broker firms.

[8] https://www.wsj.com/articles/limits-on-wall-street-pay-are-back-on-regulators-agenda-11551839333

**Fraudulent Comment Letters**

On November 15, 2018, the SEC held a roundtable in Washington, D.C. focusing on "the current proxy voting mechanics and technology, the shareholder proposal process, and the role of proxy advisory firms."[9] The SEC solicited public comments on those topics and received over 18,000 submissions following announcement of the roundtable.[10] In August of this year, the SEC issued two forms of guidance relating to the proxy process.[11] And on November 5, 2019, the SEC released the two Proposals.

The Proxy Access Proposal would impose new burdens on shareholders seeking to submit proxy proposals, including higher ownership thresholds, more onerous resubmission standards, and additional procedural requirements. The Proxy Adviser Proposal would increase the burdens on proxy advisers by treating them as engaged in proxy ***solicitation*** and by conditioning certain exemptions currently available to those advisers upon compliance with additional disclosure and procedural requirements. These important and increasingly high-profile issues have generated intense debate, along with heavy lobbying by corporate interests who seek to limit the influence of minority shareholders in the governance of their public companies.

At the open meeting on November 5, 2019, Chairman Clayton issued a statement in support of the Proposals.[12] In that statement, he singled out as particularly influential seven specific comment letters, purportedly filed by everyday citizens after the roundtable. Those letters all expressed strong support for new measures that would limit the influence of proxy adviser firms. In Chairman Clayton's words,

> "Some of the letters that struck me the most came from long-term Main Street investors, including an army veteran and a Marine veteran, a police officer, a retired teacher, a public servant, a single mom, a couple of retirees who saved for retirement, all of whom expressed concern about the current proxy process."

The clear intent of those comment letters and of Chairman Clayton's public reference to them was to convey the impression that the Proposals were strongly supported by everyday investors, not only by large corporate interests, their boards, and their trade association allies.

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9 Securities and Exchange Commission, Spotlight on the Proxy Process (Nov. 15, 2018), *available at* https://www.sec.gov/proxy-roundtable-2018; *see also* Securities and Exchange Commission, Statement Announcing SEC Staff Roundtable on the Proxy Process (July 30, 2018), *available at* https://www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process

10 Securities and Exchange Commission, Comments on Statement Announcing SEC Staff Roundtable on the Proxy Process, *available at* https://www.sec.gov/comments/4-725/4-725.htm

11 Securities and Exchange Commission, Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Release No. 34-86721 (Aug. 21, 2019), *available at* https://www.sec.gov/rules/interp/2019/34-86721.pdf; Securities and Exchange Commission, Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release Nos. IA-5325; IC-33605 (Aug. 21, 2019), *available at* https://www.sec.gov/rules/interp/2019/ia-5325.pdf.

12 Statement of Chairman Jay Clayton on Proposals to Enhance the Accuracy, Transparency and Effectiveness of Our Proxy Voting System (Nov. 5, 2019), *available at* https://www.sec.gov/news/public-statement/statement-clayton-2019-11-05-open-meeting.

However, on November 19, 2019, just two weeks following Chairman Clayton's statements and the Commission's vote to release the Proposals, a Bloomberg article appeared that cast grave doubts on the authenticity of dozens of comment letters submitted to the SEC, including the seven comment letters highlighted by Chairman Clayton.[13] The article included the appalling revelation that those seven letters, along with at least 19 additional letters in the comment file, were either fraudulent or materially misleading with respect to the identities of the signers. According to the article, several people denied ever signing the letters that bore their names; several people were prevailed upon to sign their letters without any understanding of the issues they were supposedly addressing; and numerous signers were people with close connections to an advocacy group known as "60 Plus Association" ("60 Plus"), which is funded by corporate supporters of the Proposals. As further reported in the article, those signers included former employees of 60-Plus; a contractor for the group; and friends and relatives of the President of the organization—none of whom disclosed their connection to 60-Plus in their letters.

If the allegations prove to be true, then the notice and comment process for these two SEC Proposals has been corrupted, the administrative record on which they rest is defective, and any final rules predicated on that record would be subject to challenge under the Administrative Procedure Act. Accordingly, we have called upon the SEC to investigate these matters, take remedial measures, hold the wrongdoers accountable, and identify long-term measures that could effectively detect and address such alleged abuses in the future. And because the problem is not confined to the SEC or any one agency, have also urged other financial regulatory agencies as well as the Department of Justice to determine whether similar abuses have occurred in connection with other rulemakings. We urge the Committee to consider appropriate action on this matter as well.

**Conclusion**

Thank you for the opportunity to share our perspective on these important matters, and thank you for the Committee's leadership in conducting effective oversight of the SEC's operations and policymaking.

Sincerely,

Jeremy Bratt
Director of External Affairs

Lev Bagramian
Senior Securities Policy Advisor
Better Markets
1825 K Street NW, Suite 1080
Washington, DC 20006

13 Zachary Mider and Ben Elgin, *SEC Chairman Cites Fishy Letters in Support of Policy Change*, BLOOMBERG, *available at* https://www.bloomberg.com/news/articles/2019-11-19/sec-chairman-cites-fishy-letters-in-support-of-policy-change.

**BON SECOURS MERCY HEALTH**

December 6, 2019

The Honorable Sherrod Brown
United States Senate
Senate Committee on Banking, Housing and Urban Affairs
Washington, DC 20510

Dear Ranking Member Brown:

On behalf of Bon Secours Mercy Health, I understand that the Honorable Jay Clayton, who serves as Chairman of the U.S. Securities and Exchange Commission, will appear before the Senate Committee on Banking, Housing and Urban Affairs on December 10, 2019, regarding oversight of the Securities and Exchange Commission (SEC).

As I am sure you are aware, the SEC recently issued its proposed new rules for filing of shareholder resolutions, which propose changes to the resolution filing requirements: S7-23-19 Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8; and S7-22-19 Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice.

In the event that a dialogue ensues among committee members on this proposal, I wanted to bring to your attention, as well as to the attention of Senators Scott, Van Hollen, and Warner, that our ministry, which provides services throughout your respective states, intends to file comments to the SEC at the beginning of the year. We believe if implemented as proposed, the rules will have a chilling effect on shareholders who urge companies to address a variety of social and environmental concerns, particularly small investors.

As shareholders in these companies, our health system believes we need to have the continued ability to engage a range of small to large corporations on environmental, social and governance (ESG) issues. Our goal is to establish an integral process for these entities to mitigate reputational, legal, and financial risks, and build value. Moreover, our engagement helps to provide a voice for community populations in need of socio-economic attention, including the opioid crisis, human trafficking and environmental impacts.

Thank you for your consideration.

Sincerely,

Jerome Judd

Jerome Judd
Senior Vice President, Treasury
Bon Secours Mercy Health

cc: The Honorable Tim Scott, United States Senator, South Carolina
The Honorable Chris Van Hollen, United States Senator, Maryland
The Honorable Mark Warner, United States Senator, Virginia

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INTERFAITH CENTER ON CORPORATE RESPONSIBILITY

# The Business Case for the Current SEC Shareholder Proposal Process

April 2017

## About Ceres

**Ceres** is a sustainability nonprofit organization working with the most influential investors and companies to build leadership and drive solutions throughout the economy. Through our powerful networks and advocacy, we tackle the world's biggest sustainability challenges, including climate change, water scarcity and pollution, and human rights abuses.

The **Ceres Investor Network on Climate Risk and Sustainability** comprises more than 130 institutional investors, collectively managing more than $17 trillion in assets, advancing leading investment practices, corporate engagement strategies and policy solutions to build an equitable, sustainable global economy and planet. For more information, visit www.ceres.org.

## About ICCR

**The Interfaith Center on Corporate Responsibility (ICCR)** is a 46 year-old, pioneer coalition of over 300 organizational investors representing faith-based communities, socially responsible asset managers, labor unions, and others who engage corporations on the environmental and social impacts of their operations.

## About US SIF

**US SIF: The Forum for Sustainable and Responsible Investment** is the leading voice advancing sustainable, responsible and impact investing across all asset classes. Our mission is to rapidly shift investment practices towards sustainability, focusing on long-term investment and the generation of positive social and environmental impacts. Our 300+ members collectively represent more than $3 trillion in assets under management or advisement.

## Acknowledgements

We wish to thank our colleagues and partners who contributed to this paper: Rob Berridge (Ceres), Chris Davis (Ceres), Dan Mitler (Ceres), as well as numerous members of the Ceres, ICCR, and US SIF investor networks, and the Council of Institutional Investors.

## Contact

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## Copyright

## About this paper

This paper provides an investor perspective on the value to investors and companies of the current shareholder proposal process under SEC Rule 14a-8. It was prepared by Ceres investor program staff with major contributions from numerous investor members of the Ceres, ICCR and US SIF investor networks, who have been active in filing shareholder proposals as part of their corporate engagement and asset stewardship efforts. It is intended as a resource to help inform policy discussions about the content of Rule 14a-8 and the impact of shareholder proposals on corporate issuers, shareholder value and the U.S. economy.

## Introduction

In 1942, the U.S. Securities and Exchange Commission (SEC) promulgated its first rule regulating shareholder proposals, and the rule has been adjusted and fine-tuned repeatedly since then.[1] For more than seven decades, the shareholder proposal process has allowed both large and small shareholders to alert corporate boards and the investor community to their concerns and to request timely action on emerging, or neglected, issues. A key element of process allows shareholders who meet certain criteria to submit proposals for inclusion in the company's proxy statement for a vote by all shareholders holding voting shares.

In 2016, shareholders filed approximately 1,000 shareholder proposals with U.S. companies.[2] This includes more than 400 proposals focused on environmental and social issues, and more than 500 focused on pure corporate governance. Voting on these shareholder proposals is an important part of the exercise of institutional investors' fiduciary duty on behalf of their clients and beneficiaries. This paper describes the benefits of the current shareholder proposal process to investors, companies, and society.

The principal benefits of the current shareholder proposal process include the following, as discussed in more detail below:

- It is an essential and cost-effective tool for investors, individually and collectively, to protect and enhance the value of their investments by expressing their views to management, boards and other shareholders on major governance issues, corporate policies, and important risks and opportunities.
- It is a uniquely forward-looking, flexible, and efficient way to raise and resolve issues.
- It can benefit company managers and directors by making them aware of emerging issues that can materially affect the company's performance, without imposing significant costs.
- It helps investors to protect their ownership rights and interests and helps to hold corporate boards accountable to the owners of the corporation.
- It has led to the widespread adoption of numerous beneficial corporate governance and sustainability policies by companies.

[1] http://scholar.valpo.edu/cgi/viewcontent.cgi?article=1500&context=vulr, p. 227
[2] ISS Voting Analytics database.

- It has enabled investors to raise unaddressed systemic risks to the economy caused by companies who also face company-specific risks on the issues.
- The shareholder proposals it facilitates have been shown to improve company financial performance and value.
- It provides access to management and boards by individual and institutional investors who otherwise would not have a voice, and enables owners to aggregate their voices via proxy voting on proposals.

In short, the process as currently structured and administered works well for investors and issuers; it is fair, efficient and effective.

Business groups including The Business Roundtable[3] (BRT) and the U.S. Chamber of Commerce[4] have proposed modifications to the existing shareholder proposal process that would significantly limit shareholders' ability to use this tool to raise issues with corporate boards, who are charged with representing their interests. We believe the proposed modifications would harm the interests of investors, companies, society and the capital markets.

## Background

In 1934, Congress passed the Securities Exchange Act. Section 14 of the Act authorized the SEC, as part of its mission "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation," to develop proxy regulations "in the public interest" and "for the protection of investors." Over time, the SEC developed a body of regulations that came to be collected in Rule 14a-8, including the thresholds and limitations governing whether and how shareholder proposals are listed in the company's proxy statement.[5]

Under state laws, shareholders have a right to vote by proxy as an alternative to attending a corporate annual meeting in person to cast their vote. Shareholders also have the right to raise issues from the floor of corporate annual meetings. The SEC Proxy Rules, including Rule 14a-8, support these state law rights by ensuring that widely dispersed investors have the opportunity to raise issues and vote their shares as if they were in attendance. The company is required by the SEC to distribute a proxy statement to all shareholders prior to the meeting, which allows them to vote in absentia.

The great majority of shareholder proposals are nonbinding or advisory. Nonbinding proposals give companies the flexibility to address shareholder concerns without displacing the traditional role of the board of directors to oversee the operations of the company. Boards are free to ignore

[3] https://www.bna.com/business-roundtable-suggests-b57982082135/
[4] https://www.bna.com/us-chamber-calls-n57982063976/
[5] Matsusaka, John G. and Ozbas, Oguzhan and Yi, Irene, Why Do Managers Fight Shareholder Proposals? Evidence from No-Action Letter Decisions (January 9, 2017). USC CLASS Research Paper No. CLASS17-4. Available at SSRN: https://ssrn.com/abstract=2881408 or http://dx.doi.org/10.2139/ssrn.2881408

nonbinding shareholder proposals, although high votes (e.g., above 25-30%) send a strong signal that many investors want the issue addressed.

Majority votes very frequently spur companies to act in part because shareholders – in a sign of respect for the importance of the Rule 14a-8 process – are more likely to withhold their support from directors that ignore shareholder proposals that receive majority levels of shareholder support. This flexibility is an inherent strength of the existing shareholder proposal process, which serves as an important warning mechanism for boards.

The resolution process now operates within the context of the rapid growth of environmental, social and governance (ESG)-related investment practices and increasing materiality to investors of a range of ESG issues. More than 20 percent of assets under professional management in the United States are now associated with various forms of ESG investing according to US SIF Foundation's 2016 *Report on US Sustainable, Responsible and Impact Investing Trends,* a 33 percent increase since 2014.[6] The more than 1,600 signatories to the Principles for Responsible Investment, collectively managing over $60 trillion, are publicly committed to six principles including "active ownership" and to "seek appropriate disclosure on ESG issues by the entities in which we invest."[7] Large investment firms, including Bank of America / Merrill Lynch, Blackrock, Credit Suisse, Goldman Sachs, Morgan Stanley, State Street Global Advisors, UBS, and others provide numerous research and investment products focusing on ESG topics. Many investors view ESG performance as a valuable proxy for the quality of corporate management and a key indicator of long-term financial performance.

Support for shareholder proposals comes from a broad base of investors. The vast majority of proposals are filed by institutional owners with large and long-term holdings or individuals with similarly long-term interests, with the balance coming from smaller institutional investors. Shareholder support for proposals has climbed steadily and represents a significant proportion of investors. In 2016, 61 percent of proposals that came to a vote received at least 25 percent support from shareholders, up from 31 percent with that level of support in 2000.[8] The proportion of proposals that win the support of a majority of shareholders has risen too. In 2016, 21 percent of proposals received a majority of votes cast, up from 15 percent in 2000.

## Examples of shareholder proposals that were widely adopted

For over half a century, the shareholder proposal process has served as an effective way for investors to provide corporate management and boards with insights into their priorities and concerns regarding corporate governance, policies and practices. The process has resulted in numerous important changes to corporate governance in the U.S. Examples include:

[6] http://www.ussif.org/files/Trends/US%20SIF%202016%20Trends%20Overview.pdf
[7] https://www.unpri.org/about
[8] ISS Voting Analytics

- Resolutions were the impetus behind the now standard practice – currently mandated by major US stock exchanges' listing standards – that independent directors constitute at least a majority of the board, and that all the members of the following board committees are independent: audit, compensation, nominating and corporate governance.
- In 1987 an average of 16 percent of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81 percent level of support on average. Ten years ago, fewer than 40 percent of S&P 500 companies held annual director elections compared to more than two-thirds of these companies today.[9]
- Electing directors in uncontested elections by majority (rather than plurality) vote was considered a radical idea a decade ago when shareholders pressed for it in proposals they filed with numerous companies. Today, 90 percent of large-cap U.S. companies elect directors by majority vote, largely as a result of robust shareholder support for majority-voting proposals
- A proposal that built momentum even more rapidly and influenced the practices of hundreds of companies in the last few years is the request for proxy access. Resolutions filed by the New York City Comptroller to allow shareholders meeting certain eligibility requirements to nominate directors on the company's proxy ballot achieved majority votes at numerous companies. As a result, since 2015, at least 400 companies have adopted proxy access bylaws.
- "Say-on-pay" vote requirements – now mandated by the Dodd-Frank Act – also resulted from shareholder proposals.
- Shareholder proposals or related engagements played a key role in moving close to 160 large companies (including more than half of S&P100 companies) to commit to disclosure and board oversight of their political spending with corporate funds.[10]
- Since 2009, 85 companies have agreed to issue sustainability reports as result of shareholder resolutions. According to the G&A Institute, 81 percent of S&P 500 companies published sustainability reports in 2015 compared to just under 20 percent in 2011.[11]
- The first resolution requesting that companies source deforestation-free palm oil went to vote in 2011. By 2016 more than 20 companies had responded to similar resolutions and protected their brands' reputations by committing to source deforestation-free palm oil produced by workers free from human rights abuses.[12]
- Shareholder proposals have led to wide-scale adoption of international human rights principles as part of corporate codes of conduct and supply chain policies, protecting companies from legal and reputational risk.
- A substantial majority of large companies have sexual orientation nondiscrimination policies largely as a result of hundreds of shareholder proposals. A 2016 analysis by Credit Suisse

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[9] AFL-CIO letter to Stanford professors Larcker and Tayan, January 18, 2013
[10] http://politicalaccountability.net/impact
[11] http://www.ga-institute.com/press-releases/article/flash-report-eighty-one-percent-81-of-the-sp-500-index-companies-published-corporate-sustainabi.html
[12] Data compiled by Ceres.

found that 270 companies which provided inclusive LGBTQ work environments outperformed global stock markets by 3 percent annually for the previous six years.

## Benefits to investors

### The shareholder proposal process helps to protect investor interests

Common stockholders generally have six types of basic rights: the right to file and vote on shareholder proposals and to vote to elect directors (however not all share classes have voting rights); ownership in a portion of the company and a claim on a portion of the assets; transfer of ownership; entitlement to a portion of dividends set by the board of directors; the opportunity to inspect corporate books and records; and the right to sue for wrongful acts, including class action suits. (Corporate bylaws influence these rights, but they are generally applicable as listed.)

These rights are necessary but at times insufficient to protect investor interests. Chief among investor interests is maximizing risk-adjusted, long-term, portfolio-wide returns. And institutional investors generally have a fiduciary duty to act in the interest of their clients and beneficiaries.

As investors seek to protect their interests in accordance with their rights and obligations, they are confronted with a challenge. The tools they have to influence corporate behavior are more easily asserted after things have gone wrong with the company they own, when the issue is widely obvious, and the value of their investment has been impaired.

The shareholder resolution process is important because it allows investors to communicate with boards, management and other shareholders about ways to protect their interests in a proactive, forward-looking way on important corporate governance, risk and policy issues affecting companies, before a crisis arises that erodes shareholder value.

### It promotes good corporate governance

The substantial history of corporate scandals clearly demonstrates that the separation of corporate ownership and control allows managers substantial leeway to pursue their own interests, which can at times be at the cost of shareholder wealth.[13] The shareholder resolution process acts as a critical safeguard against these agency problems, and enables all shareholders holding voting stock, including relatively small ones, to encourage management and boards to address ESG issues that they believe are significant to the company and to society.

Examples of managerial strategies that could be classified as "ESG failures" and were disastrous for investors and employees abound: AIG, Bear Stearns, Lehman Brothers, BP, Enron, WorldCom, Fannie Mae and Freddie Mac, Massey Energy, Volkswagen and Wells Fargo. Scandals and disasters are the visible portion of the larger iceberg of incentives that lure corporate managers to manage for the short term and take excessive risk at shareholders' expense.

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[13] The Modern Corporation and Private Property. By Adolf A. Berle, Jr. and Gardiner C. Means. New York: The Macmillan Company, 1932.

The world's largest asset managers are acting to address these risks. A letter sent in January 2017 from State Street Global Advisors' CEO Ron O'Hanley to board members of companies in which State Street owns shares says that ESG issues "can have a material impact on a company's ability to generate returns," and that "as stewards we are convinced that addressing ESG issues is a good business practice and must be part of effective board leadership and oversight of long-term strategy."[14] In addition, The Investor Stewardship Group, a coalition of sixteen of the largest institutional investors managing $17 trillion collectively, premiered in January 2017 the Framework for U.S. Stewardship and Governance, outlining a set of six fundamental governance principles for U.S. listed companies.[15]

However, few investors have the clout and access to boards enjoyed by the very largest institutional investors, and shareholder proposals and proxy voting are critical tools to urge companies to adopt the best corporate governance practices and to address material ESG issues.

### The proposal process helps enhance board accountability

Boards of directors are charged with ensuring that company management acts in the best interests of the company and its shareholders. In reality, they sometimes fail in this regard for a number of reasons including: use of insufficient or incorrect information; "group think" and lack of diversity; an overly deferential approach to the managers they oversee; or by acting in their own interests. Shareholder proposals can strongly encourage boards and management to address ESG issues that they might otherwise overlook or ignore.

Investors have several tools to communicate with corporate boards tasked with representing shareholder interests. Proxy voting is one. However, without the ability to put items on the proxy, most investors would lack sufficient influence and access to convey their concerns and requests to the board.

Voting against (or withholding votes from) directors is one option for shareholders, but this is a blunt instrument, providing the director no information as to the rationale for the vote, or the underlying issue. And voting against directors due to a specific environmental or social problem is likely to gain momentum only after an adverse event occurs, by which time investors will already have seen the damage to returns. On the other hand, shareholder proposals allow investors to signal their expectations and/or displeasure on individual ESG issues without resorting to withholding their vote from directors.

Successful boards must be knowledgeable about and responsive to a wide range of issues affecting the company. Provided with enough information and a strong enough signal from shareholders, directors and management can often successfully address ESG issues. One of the

[14] In March of 2017, State Street managed approximately $2.4 trillion. https://www.ssga.com/investment-topics/environmental-social-governance/2017/Letter-and-ESG-Guidelines.pdf

[15] https://corpgov.law.harvard.edu/2017/02/01/promoting-long-term-value-creation-the-launch-of-the-investor-stewardship-group-isg-and-isgs-framework-for-u-s-stewardship-and-governance/

most important ways of sending that signal to companies and their directors is through the shareholder proposal process.

### Benefits to small and individual investors

The shareholder proposal regulatory process allows both small institutional investors and individual shareholders to alert boards to management's need to take timely action on emerging and critical ESG issues.

A system that allows shareholders to file proposals is needed in part because individual investors and smaller shareholders nearly always lack large enough holdings to get the board and management's attention in any other way. As Berle and Means argued in the 1930s, "shareholders often are virtually powerless against management, because each individual shareholder owns only a very small percentage of the outstanding shares..."[16]

The voting process allows one investor to raise an issue, make supporting arguments in the company's proxy materials, educate other investors, and then aggregate the votes of other investors who agree the issue needs to be addressed. Small shareholders filing proposals often catalyze beneficial actions and changes in corporate governance and practices that benefit the company and all shareholders. And many large asset owners and asset managers who rarely file shareholder proposals now vote for ESG proposals filed by smaller shareholders.

For example, in 2016, Walden Asset Management, which manages $3 billion for clients focused on sustainable and responsible investment, filed a proposal with CLARCOR, a water filtration company, requesting a sustainability report including disclosure of greenhouse gas reduction goals. The following asset managers are among those that voted for the proposal, which received 61 percent support: Deutsche, Goldman Sachs, John Hancock, Mass Mutual, Northern Trust, ProShares, Schroders, State Street, TIAA-CREF and Wells Fargo.[17]

In 2016, at least 18 large U.S. mutual fund companies voted for more than 50 percent of climate change-related resolutions, including: Alliance Bernstein, GMO, Lazard, Morgan Stanley, MFS, Natixis, Northern Trust, Schroder, and Wells Fargo.[18]

Corporate directors have limited time and resources. As a result, when they do meet with investors, they generally only meet with the company's largest shareholders, who therefore have a reduced need to submit proposals to get a board's attention. The shareholder proposal process ensures that boards can hear from investors of all sizes. Without this process, boards can be largely insulated from the concerns and perspectives of the wider shareholder base.

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[16] The Modern Corporation and Private Property. By Adolf A. Berle, Jr. and Gardiner C. Means. New York: The Macmillan Company, 1932.
[17] According to analysis by Fund Votes
[18] https://www.ceres.org/press/blog-posts/is-your-mutual-fund-company-taking-climate-change-seriously

### Benefits to passive and long-term investors

While active investors have the option of selling shares of companies whose management they do not trust to add value, passive investors' options are more limited. BlackRock CEO Larry Fink addresses head-on the benefits of (and need for) shareholder engagement for passive investors:

"BlackRock engages with companies from the perspective of a long-term shareholder. Since many of our clients' holdings result from index-linked investments – which we cannot sell as long as those securities remain in an index – our clients are the definitive long-term investors. As a fiduciary acting on behalf of these clients, BlackRock takes corporate governance particularly seriously and engages with our voice, and with our vote, on matters that can influence the long-term value of firms. With the continued growth of index investing, including the use of ETFs by active managers, *advocacy and engagement have become even more important for protecting the long-term interests of investors.*"[19] [Emphasis added.]

Such engagement includes both private company dialogues by large investors like BlackRock and State Street and shareholder proposals by other smaller investors who often find it difficult to get the attention of management and boards through voluntary engagement.

Investors that utilize active management strategies also have a strong interest in engagement and filing shareholder proposals for the same reasons that these investors value the ability to vote their proxies. Active trading can be costly and is ineffective in addressing long-term governance failures at corporations. Most active investors have an interest in the long-term sustainability of corporations they invest in, regardless of their individual portfolio management strategies. Active investors may wish to continue to hold a stock for financial reasons but still maintain concerns about certain governance, risk management or disclosure practices that a shareholder proposal could effectively address. Similarly, active investors that sell a stock today will generally want to be able to purchase that stock again in the future. Their interest in the long-term value of any particular company can be independent of their trading strategies.

It is also important to recognize that while passive investors are unable to sell shares in order to avoid certain risks, active investors are also exposed to the economy-wide systemic risks that shareholder proposals are uniquely positioned to address. Three University of Cambridge research institutions explain this reasoning in their 2015 paper *Unhedgeable Risk: How Climate Change Sentiment Impacts Investment*. The paper argues that: "Short-term shifts in market sentiment induced by awareness of future, as yet unrealised, climate risks could lead to economic shocks, causing substantial losses in financial portfolio value within timescales that are relevant to all investors."[20]

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[19] https://www.blackrock.com/corporate/en-us/investor-relations/larry-fink-ceo-letter
[20] http://www.cisl.cam.ac.uk/publications/publication-pdfs/unhedgeable-risk.pdf

## Benefits and costs to companies

### The proposal process is efficient compared to the alternatives

The Business Roundtable states: "As set forth in our 2012 Principles of Corporate Governance, we believe it is the responsibility of the corporation to engage with long-term shareholders in a meaningful way on issues and concerns that are of widespread interest to long-term shareholders, with appropriate involvement from the board of directors and management."[21] For all the reasons described in this paper, the current shareholder proposal process is one of the most effective ways for shareholders to engage the companies in which they invest.

Alternatives to shareholder proposals include voting against directors, lawsuits, books and records requests, and requests for additional regulations. Each of these is more onerous and adversarial than including a 500-word proposal in the proxy statement for the consideration of shareholders. Most importantly, any analysis of costs (discussed below) of the proposal process must be balanced against the benefits. Poor corporate governance and inadequate ESG practices hurt company performance and investor returns, sometimes in catastrophic ways, as described above.

### Companies frequently agree to act on the request made in the proposal

Many shareholder proposals result in agreements between the filing shareholder and the company. An average of 37.5 percent of shareholder proposals related to climate change during the 2012-2016 proxy seasons were withdrawn by filers in response to the company agreeing in some form to the request. Withdrawal rates for some other topics is far higher. The New York City Comptroller's Office withdrew 80 percent of the 45 proxy access resolutions it filed during the 2016 and 2017 proxy seasons due to commitments by 36 companies. These examples of high 'agreement rates' suggest that many companies find benefits in committing to act on shareholder proposals before they go to a vote.

### The cost to companies is generally low and spending is within their control

The Business Roundtable suggests that companies spend an average of about $87,000 per shareholder proposal.[22] This figure originates from an SEC release in which the SEC attempted to utilize limited and ambiguous data to calculate costs associated with the shareholder proposal process. Prior to its 1998 rulemaking, the SEC surveyed companies regarding the costs of the process. The questionnaire contained ambiguous questions yielding results that do not support the above figure.

First, the SEC asked how much it costs companies per year to determine whether or not to include shareholder proposals, including following the exclusion rules and procedures. Because the question was ambiguously worded, the average figure of $37,000 per year arguably applied to the total cost to companies of considering whether or not to include <u>all</u> proposals. It did not appear to

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[21] http://businessroundtable.org/resources/letter-sec-rule-shareholder-proposal-resubmissions

[22] https://www.sec.gov/comments/4-537/smbainbridge7785.pdf;
https://www.uschamberfoundation.org/sites/default/files/article/foundation/Analysis%20of%20the%20Wealth%20Effects%20of%20Shareholder%20Proposals_0.pdf

reflect the cost per proposal. The wide range of responses to the question from $10 to $1,200,000 (a median value of $10,000) also reflects the ambiguity of the issue and question, as well as the range of resources expended by companies in their discretion in response to shareholder proposals. Similarly, the SEC reported survey results indicating an average cost of $50,000 to publish proposals, and as with the first question it appeared that this may be the average cost for including all proposals in the proxy, rather than a per proposal expense.[23] These ambiguities in the original questionnaire and responses undermine the conclusion that it costs companies an average of $87,000 per proposal.

Most companies receive few, if any, shareholder proposals. While there are about 4,000 publicly listed companies in the U.S. (excluding over-the-counter stocks)[24], in 2016 approximately 1,000 resolutions were filed[25] – or approximately 1 proposal every 4 years per company on average.[26] Moreover, most proposals tend to be filed with larger (i.e., S&P 500) companies, which have the resources to deal with such shareholder input. The number of shareholder proposals in recent years has not been significantly increasing. Rather the number of proposals has vacillated from a high of 1,126 in 2009 to a low of 691 in 2011.[27]

Finally, the SEC oversees a robust "no-action letter" system that allows companies to exclude proposals from the proxy ballot that do not meet certain procedural and/or substantive hurdles. Requesting an informal no-action letter provides companies with a means of knowing whether the SEC Staff would recommend no enforcement action if the company's excludes the proposal from the proxy. During the 2013-2015 proxy seasons companies challenged nearly one-third of shareholder proposals submitted. About half of those challenged proposals were omitted from the proxy with SEC approval.

### Studies show financial performance benefits to companies receiving resolutions and for strong ESG performance

A substantial body of literature shows that companies that have superior sustainability or ESG performance perform at least as well as, and often better than, less sustainable peers. Thus, issues raised in shareholder proposals are often financially material to companies.

- A recent analysis of more than 2,000 empirical studies concluded that approximately 90 percent of those studies found that the relationship between ESG and financial performance was either positive or zero. Only ten percent of the studies showed a negative relationship. Morningstar's research from 2015 shows that large-cap U.S. funds with high Morningstar Sustainability Ratings have lower risk.[28]
- A 2015 study found that successful ESG engagements generate cumulative (1999-2009) excess returns of +7.1 percent. Moreover, unsuccessful engagements (ones that didn't result

[23] https://www.sec.gov/rules/final/34-40018.htm
[24] http://money.cnn.com/2015/07/09/investing/stock-market-shrinking/
[25] Data provided by the Sustainable Investments Institute.
[26] ISS Voting Analytics database.
[27] http://static1.1.sqspcdn.com/static/f/276323/27013100/1462553848273/J+Brown_THE+EVOLVING+ROLE+OF+RULE+14A-8+IN+THE+CORPORATE+GOVERNANCE+PROCESS.pdf?token=eOvlI5sXwVYJld48V6JQYXw1OuA%3D P.181
[28] Higher Sustainability Ratings Can Mean Lower Risk Jon Hale, Morningstar, October 13, 2015

in any corporate action) experienced no change in market value.[29] This suggests that while proposals that lead to corporate action on an ESG issue can be significantly beneficial for companies and shareholders, proposals that don't lead to action cause no harm.

- A 2014 study that tracked two groups of companies (categorized as high / strong or low / weak on sustainability) between 1993 and 2009 found that high sustainability companies significantly outperformed their counterparts over the long-term in terms of stock market and accounting performance.[30]
- A recent study by Wilshire of the effect of CalPERS' corporate governance activism on targeted company share prices shows that, for the three years prior to the engagement, targeted companies significantly underperformed the Russell 1000 index, while for the five years following the engagement, they significantly outperformed the same index.
- An academic study conducted in 2016 found that "[F]irms that adopted shareholder resolutions on long-term [executive] compensation experienced a significant increase in their stock price.... Overall, the findings of this study suggest that long-term incentives improve a firm's governance as well as its impact on society and the natural environment."[31]
- Additional studies are available here.

## The current rules and thresholds are appropriate and should be maintained

As mentioned earlier, the current proposal process has been refined and fine tuned since 1943, and works well in its current form. The existing process is flexible, allowing investors to tailor their requests to address company-specific issues as they arise. As a result, the proposals filed each year reflect market conditions and evolving best practices. These benefits are closely related to the specific thresholds and criteria in Rule 14a-8, which we believe should be maintained.

### The value of existing filing thresholds

Under the current SEC rule, to submit a proposal, investors most hold at least $2,000 worth of shares continuously for at least one year. The one year holding requirement ensures that the use of the shareholder proposal rule is appropriately limited to longer-term shareholders. For example, the current tax code also uses one year to distinguish short-term capital gains from long-term gains.

Any proposals to significantly increase the filing threshold would exclude many smaller investors from filing. This raises serious fairness and efficacy concerns. For example, religious organizations are long-time leaders in filing constructive shareholder proposals. Some of these filers are very small investors who would be forced out of the system if the filing threshold were raised significantly. Large investors do not have a monopoly on good ideas, and they already have greater access to boards than smaller investors, as previously described. The current shareholder

[29] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2154724
[30] http://pubsonline.informs.org/doi/abs/10.1287/mnsc.2014.1984
[31] https://irrcinstitute.org/wp-content/uploads/2016/12/2016-Academic-Winner-by-Flammer1.pdf

proposal system harnesses the power of a marketplace of ideas, and barring small investors from participating in this marketplace would be as unwise as it is unfair.

Prior to 1983 there was no dollar threshold for submitting a proposal. In 1983 the SEC adopted a \$1,000 requirement. In 1998 the SEC raised the threshold to \$2,000.[32] They declined to raise the threshold further "out of concern that a more significant increase would restrict access to companies' proxy materials by smaller shareholders, who equally with other holders have a strong interest in maintaining channels of communication with management and fellow shareholders."[33] If the amount were adjusted for inflation since 1998 the current threshold would increase to about \$2,946.[34] Therefore, the existing filing threshold is close to what the SEC felt in 1998 was necessary to avoid excluding smaller shareholders.

### The value of existing resubmission thresholds:

In order to resubmit a proposal under current rules, it must have received at least 3 percent of the vote on its first submission, 6 percent on the second and 10 percent on the third. The BRT has proposed that at the very least the thresholds should be updated to implement the increases proposed in 1997: 6 percent on the first submission, 15 percent on the second and 30 percent on the third. The percentage of proposals since 2000 that are estimated to fall below those thresholds are 13.32%, 31.5%, and 50.14%, respectively.

As noted above, experience indicates that it often takes several years for a proposal on an emerging issue to gain traction with investors and to achieve double-digit votes. In many instances these proposals eventually receive substantial support, leading to widespread adoption by companies. The current thresholds provide a reasonable amount of time for emerging issues to gain support among investors while ensuring that only those proposals that garner meaningful support remain on the ballot for multiple years.

It is also important to keep in mind the following, which can contribute to low votes on shareholder proposals:

1. Some companies have high insider ownership and insiders can be expected to vote with management;
2. Companies can use multiple share classes that can reduce votes;
3. Broker non-votes and abstentions can be used to reduce vote percentages if they are added to denominator when votes are calculated. The great majority of firms use the simple formula "For / For + Against" when calculating votes, which is the method used by the SEC for assessing whether resubmission thresholds have been met;
4. A few of the very largest asset managers still routinely vote against (or abstain from voting on) all resolutions with environmental and social elements.

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[32] https://www.sec.gov/rules/final/34-40018.htm
[33] https://www.sec.gov/rules/proposed/34-39093.htm
[34] https://www.bls.gov/data/inflation_calculator.htm

### Existing SEC rules preclude proposals relating to 'ordinary business'

The SEC's current guidance on allowing companies to exclude from the proxy any resolutions pertaining to a company's ordinary business appropriately states that resolutions need to pertain to "significant policy issues" faced by companies.[35] This approach strikes a critical balance between respecting the board's role on corporate governance and management's discretion on routine business decisions, while also recognizing the existence of policy issues significant enough to warrant a shareholder vote.[36]

As Staff Legal Bulletin No. 14E (2009), made clear, a primary benefit of the shareholder resolution process is the ability for investors to help companies address issues that are currently (or may soon become) significant risks that are not widely recognized or appreciated by the company. Resolutions focusing on risks are among the most critical examples of how the private ordering system of the proposal process should work. Investors must be permitted to focus the board and management's attention on unaddressed risks. This system harnesses market forces by allowing shareholders to highlight risks their companies face and ask the companies to act to reduce the risks.

### SEC rules to prevent abuse of the system by special interests

Under existing SEC rules, the voting process prevents undue influence from special interests as well as frivolous resolutions. The SEC's "no-action letter" system relies on rules that bar proposals: pertaining to "personal interests;" relating to operations accounting for less than 5 percent of gross sales; "that the company would lack the power or authority to implement;" dealing with "ordinary business operations;" that the company has "already substantially implemented;" or that "relates to specific amounts of cash or stock dividends."[37]

Any resolutions that survive the no-action process but subsequently generate low votes are then excluded by the current resubmission thresholds. Under this part of the system, decisions about what should go on the ballot are primarily in the hands of voting investors. As Matt Orsagh, a corporate governance expert with the CFA Institute, told Bloomberg BNA, "We prefer to let investors decide for themselves whether a proposal is worthy of their time."[38]

## Conclusion

It is not surprising that corporate managers and their trade associations may not see the materiality of corporate governance and ESG issues in exactly the same light as investors. The median CEO tenure at S&P 500 companies as of 2014 was six years.[39] Generally speaking, CEOs can be expected to try to maximize share prices and returns during their tenure, a reality partially

[35] Staff Legal Bulletin No. 14E: https://www.sec.gov/interps/legal/cfslb14e.htm
[36] https://www.sec.gov/interps/legal/cfslb14h.htm and Medical Committee for Human Rights v. SEC, 432 F.2d. 659, 680-681 (1970), vacated and dismissed as moot, 404 U.S. 402 (1972).
[37] https://www.sec.gov/interps/legal/cfslb14.htm
[38] https://www.bna.com/us-chamber-calls-n57982063976/
[39] http://www.equilar.com/blogs/59-ceo-tenure.html

responsible for the so-called "tyranny of short-termism."[40] But investors saving for retirement and other long-term shareholders have much longer-term interests.

These long-term perspectives can also be helpful to company financial performance. A 2014 study of the effect of long-term investors on corporate decision-making shows that "long-term investors restrain numerous corporate misbehaviors such as earnings mismanagement and financial fraud…" and foster shareholder input into board and management decisions.[41]

The shareholder resolution process allows investors to ask boards and management to address issues that affect the long-term interests of investors. At the same time, the existing process allows companies to exclude frivolous resolutions, those that seek to micro-manage, or that intrude on management's ordinary business judgment. Through use of precedent, the existing no-action letter process sends strong signals to resolution filers to avoid filing resolutions that are likely to be excluded, thereby enhancing the efficiency of the system.

The resolution process provides a needed and effective tool to the growing ranks of passive index investors who often cannot divest shares when they have concerns about corporate governance and other ESG issues. But their fiduciaries can use shareholder proposals to influence the behavior of boards and management and encourage companies to address material corporate issues. And the votes of their fellow investors can send a powerful signal about the importance of these issues to investors. Hence shareholder proposals provide a valuable service to all shareholders, allowing them to signal boards and management in an advisory capacity.

The current U.S. shareholder proposal system provides important benefits for investors and companies. It is a key tool for the assertion of shareholder rights, helps ensure accountability of boards and management, and enables shareholders to focus corporate attention on important issues that may otherwise escape attention. Changing the existing finely tuned SEC rules and practices for overseeing shareholder proposals is likely to do much more harm than good.

[40] https://hbr.org/2011/03/capitalism-for-the-long-term
[41] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2505261

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**STATEMENT FOR THE RECORD**
**BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS**
**OF THE UNITED STATES SENATE**

December 9, 2019

**VIA FEDEX AND EMAIL**

The Honorable Mike Crapo
Chairman
Committee on Banking
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking
United States Senate
Washington, DC 20510

Re: Oversight of the Securities and Exchange Commission
December 10, 2019

Dear Chairman Mike Crapo, Ranking Member Sherrod Brown and Members of the Committee:

Gabelli Funds, LLC ("Gabelli Funds") respectfully requests the following statement be made part of the record of the Oversight Hearing scheduled by the Committee on Banking, Housing and Urban Affairs (the "Committee") of the United States Senate concerning the Securities and Exchange Commission (the "SEC" or "Commission").

Gabelli Funds is a registered investment advisor subject to regulation under the Securities and Exchange Commission ("SEC" or "Commission"). Its clients include fourteen Gabelli Investment Funds, registered as closed-end investment management companies under the Investment Company Act of 1940 ("1940 Act"), which the Commission is charged with enforcing. These Funds with total assets of approximately $7.3 billion are all listed on the New York Stock Exchange.

When the Adviser learned of this hearing, we believed it to be an important opportunity to ensure the Committee is aware of current matters involving closed-end funds and the SEC's role as protector of them and their investors. We strongly believe the Committee can effectively and productively exercise its jurisdiction by adapting regulation to address current abuses or creating new legislation to enhance investor protection in a market that provides critical levels of income for Main Street investors including retirees.

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**Closed-end Fund Overview**

An estimated 3.6 million U.S. households own closed-end funds.[1] Closed-end funds have provided Main Street investors an attractive medium for income and capital appreciation for over a century; this investment format predates the Investment Company Act of 1940 and the better-known structures of open-end mutual funds and exchange-traded funds. Today, there are nearly 500 closed-end funds[2] with approximately $250 billion of assets.[3] Closed-end funds pay an average 6.9% annual distribution to shareholders. This distribution is generally paid monthly[4] from a combination of interest, dividends, capital appreciation, and paid in capital. In an investment environment with Treasury yields under 2% and negative yields prevalent in foreign government bonds, such high payouts are attractive to retirees seeking income to fund their expenses. Approximately 37% of the 3.6 million households invested in closed-end funds are retired, a larger percentage than the ownership base of other structures such as open-end mutual funds.[5]

In addition to the consistent distribution closed-end funds provide to investors and retirees, their long-term investment horizon provides attractive capital for growing companies. The investments made by closed-end funds provide growing companies with capital to make investments in expanding their businesses, creating jobs, and supporting the overall economy.

The SEC's mission of a) protecting investors, b) maintaining fair, orderly, and efficient markets, and c) facilitating capital formation makes for its oversight of the closed-end fund market critical. It ensures continued efficient functioning of the valuable cash flow closed-end funds produce for Main street investors. The closed-end fund structure where investors sell shares on regulated exchanges such as the New York Stock Exchange rather than to the fund itself benefits the economy. They allow fund management to invest with a stable pool of capital and predictable cash flow, which allowed managers to more readily allocate that capital over a long-term time horizon.

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[1] *See* Duvall, James, "The Closed-end Fund Market, 2018," ICI Research Perspective 25, No. 2(April 2019), available at *www.ici.org/pdf/per25-02.pdf.*
[2] *See* www.cefconnect.com (excludes BDCs)
[3] *See* Duvall, James, "The Closed-end Fund Market, 2018," ICI Research Perspective 25, No. 2(April 2019), available at *www.ici.org/pdf/per25-02.pdf.*
[4] See Morningstar Direct℠; CEF Advisors Provides Data for CEFs, Interval CEFs, and BDCs as of 6/30/19 (Closed-End Fund Advisors, Inc.),
[5] See Duvall, James, "The Closed-end Fund Market, 2018," ICI Research Perspective 25, No. 2(April 2019), available at *www.ici.org/pdf/per25-02.pdf.*

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Having established the multifaceted value of the closed-end fund market to benefit from the investor protection mission of the SEC and this Committee, we call the Committee's attention to disturbing trends in the closed-end fund market where investor choice has become limited and income streams reduced.

**NEED FOR REVIEW**

Since 2007, there has been a decline in the number of closed-end funds by nearly 25%. One of the drivers in recent years is an increase in attacks from activist hedge fund investors seeking short-term profit at the expense of the long-term Main street investor. These self-serving entities use the Stock Exchange requirement[6] that closed-end funds have annual meetings with shareholder votes to replace directors and force liquidity events such as open market tender offers, share repurchases, or worse, liquidations.

In all of these cases, the capital of a closed-end fund is reduced or eliminated to address a short-term hedge fund investor whose interests are self-serving and deviate from the majority of the long-term shareholders. These Main street investors desire the consistent income that closed-end funds uniquely offer. The capital reduction also means the broader economy loses a source of long-term otherwise permanent funds for companies to invest, grow and create jobs.

**THE PROBLEM**

While the general concept of shareholders challenging a listed company's management is not objectionable, the method arbitrage-oriented activist hedge funds attack closed-end funds violates, at least in spirit, key clauses of the 1940 Act. Notably, Section 12(d)(1)(A)(i) of the 1940 Act states:

"It shall be unlawful for any registered investment company (the ''acquiring company'') … to purchase or otherwise acquire any security issued by any other investment company (the ''acquired company'')….. if the acquiring company and any company or companies controlled by it immediately after such purchase or acquisition own in the aggregate— (i) more than 3 per cent of the total outstanding voting stock of the acquired company;" ("3% Limit")

Section 3(c)(1) and Section 3(c)(7) of the 1940 Act require private investment companies such as hedge funds to abide by this 3% Limit just as if they were registered investment companies.

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[6] *See* NYSE Listed Company Manual §§ *704* Annual Meetings

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These provisions were drafted by Congress specifically to limit an acquiring fund from accumulating and exercising undue influence on a registered fund and its shareholders. However, arbitrage-oriented activist hedge funds evade this rule by using multiple funds with similar if not identical investment objectives. This anomaly in the rule allows activist shareholders to accumulate material voting stakes and thus exert the leverage to threaten destructive acts that are otherwise inconsistent with a Board's corporate governance and investment objectives.

When an arbitrage hedge fund achieves its goal, either a partial or full liquidation of a closed-end fund, the results are often undesired by and detrimental to the Main Street investor. The liquidation or tender offer reduces or eliminates the size of the fund. The activist investor has often times fully hedged their closed-end fund investment and often sells its remaining shares if the fund continues, making its reputation for being a short-term coercive entity well deserved.[7] The fund's income stream is disrupted, and shareholders who are invested through a taxable account and tender their shares realize capital gains and incur the taxes that go with it. A smaller fund will tend to have higher expenses with lower economies of scale.

These are destructive consequences for the remaining shareholders and detrimental to the broader economy. Long-term stable capital sources are lost to growth companies, and incentives for managers to launch new closed-end funds reduced. For all these reasons, we believe the SEC and the Committee in its oversight jurisdiction should address the increased presence of activist investors in the closed-end fund market[8].

THE SOLUTION

We urge the Committee on Banking, Housing and Urban Affairs to collaborate with the SEC to provide closed-end funds the protections they need to continue providing investors regular distributions and companies the attractive source of stable long-term borrowing capital.

- Draft legislation to close the loophole in the 3% Limit clause of the 1940 Act.

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[7] See Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934, Preliminary Proxy Statement (August 12, 2019),
available at https://www.sec.gov/Archives/edgar/data/1487610/000089843219001067/prec14a.htm
Slide 18 where one fund gives ten examples where an activist entirely or largely sells its stake after a standstill available at https://www.sec.gov/Archives/edgar/data/1487610/000089843219001173/defa14a.htm
[8] See Thomas A. DeCapo and Kenneth E. Burdon, Activists Take Another $290 Million Bite Out of Vulnerable Closed-End Fund Asset Class (June 19, 2019),
https://www.skadden.com/insights/publications/2019/06/activists-take-another-$290-million-bite

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Congress would do the investing public and the legal community a favor by revising the language of the 3% Limit to subject "investment advisors" rather than individual funds to the 3% Limit. This would adjust the law to a market reality that a) advisors are the true medium of investment management decision-making today rather than individual funds, and b) private funds are dramatically more prevalent than when the 1940 Act was passed.

- Draft legislation to subject private funds to the investment advisor 10% limit in Section 12(d)(1)(C) for which they are currently exempt. The clause subjecting private funds to the 3% Limit was not extended to a sister clause that prohibits advisors from buying over 10% of a registered investment company. Thus, advisors may surpass 10% voting control to the extent excess holdings are in private vehicles, such as hedge funds or separately managed accounts. Many arbitrage activists are mostly or entirely managers of private vehicles, including separately managed accounts and thus the intent of the clause largely misses them in applicability. In particular, this recommendation was made by the Investment Company Institute in its comment letter related to the Fund of Funds Arrangements rulemaking process in April.[9]

- Work with the SEC to build interpretive provisions protecting closed-end funds in the Fund of Funds Arrangements rulemaking process.[10]

  The Division of Investment Management has taken public comment on proposed Rule 12d1-4 loosening various fund of funds limits including that of the 3% Limit. The intent is mostly to affect open-end funds, but there would be adverse effects on closed-end funds as well. We urge Committee members and staff to reiterate a number of rulemaking positions that would strengthen investor protection:

  - Private funds should be excluded from proposed relief of the 3% Limit, especially given many operate from foreign locales outside the regulation and jurisdiction of the SEC;
  - Closed-end funds as acquired funds (or targets) should be excluded as a type of fund in which other funds could invest in excess of the 3% Limit;
  - Define "control", the threshold for which an acquiring fund is presumed to be able to exert undue influence at 10%, below the proposed 25%. This 10% matches the threshold at which outside shareholders are presumed to be insiders for purposes of public reporting.

[9] See pages 29-31 available at https://www.sec.gov/comments/s7-27-18/s72718-5433908-184637.pdf
[10] See Proposing Release available at https://www.sec.gov/rules/proposed/2018/33-10590.pdf and https://www.sec.gov/comments/s7-27-18/s72718.htm for comments.

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- Work with the SEC on interpretive matters outside the Fund of Funds rulemaking process that would strengthen protection for closed-end funds such as revising a staff position on closed-end funds adopting shareholder rights agreements to level the playing field in line with that existing for operating companies[11].

THE CONCLUSION

Gabelli Funds appreciates the attention the Committee is giving to its responsibility to exercise oversight of the SEC and to the SEC's role in protecting investors and ensuring the U.S. capital markets are efficient. We believe the Committee has the opportunity to strengthen protections for investors in closed-end funds with the above acts to modernize the 1940 Act and to prevent the closed-end structure from becoming less relevant in the investing marketplace. Threats to the attractive income streams closed-end funds distribute to their shareholders are serious and represent a clear violation of the spirit of the protections intended in the 1940 Act. Congress, working with the SEC, can take action to adapt and clarify the statute to reflect today's developments.

Sincerely,

David Goldman

David Goldman
General Counsel
Gabelli Funds, LLC

[11] *See* Andrew J. Donohue, SEC Director of Investment Management, Keynote Address at the Independent Directors Council Investment Company Directors Conference (Nov. 12, 2009), *available at* https://www.sec.gov/news/speech/2009/spch111209ajd.htm. The SEC Division of Investment Management took the opposite position in 2009.

INTERFAITH CENTER ON CORPORATE RESPONSIBILITY
*Inspired by faith. Committed to action*

November 6, 2018

Hon. Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File 4- 725 -- Staff Roundtable on the Proxy Process

Dear Chairman Clayton,

In response to your July 30th Statement announcing a Staff Roundtable on the Proxy Process, the Interfaith Center on Corporate Responsibility (ICCR), a coalition of more than 300 institutional investors collectively representing over $400 billion in invested capital, wishes to express our affirmation of the current shareholder proposal process as effective, efficient and beneficial to both shareholders and the long term well-being of the companies they hold. Our members are composed of a cross section of religious investors, foundations, asset managers, pension funds, and other long-term institutional investors. Members of ICCR have been involved in the shareholder resolution process since 1971, giving us over 45 years of experience in shareowner engagement and the proxy process.

We submit this brief comment in advance of the Staff Roundtable, and will be providing a more in-depth comment subsequent to the Roundtable.

We firmly believe that there is no need to revise the rules governing the proxy process. For decades, the shareholder proposal process has served as a cost effective way for corporate management and boards to gain a better understanding of shareholder priorities and concerns, particularly those of longer-term shareholders concerned about the long-term value of the companies that they own. This efficient system of private ordering has led to the widespread adoption of a number of constructive corporate governance practices that have become standard in the field, such as independent directors, declassifying boards, "say on pay" vote requirements, and many others. The history of ICCR demonstrates literally hundreds of examples of companies changing their policies and practices in light of productive engagement with shareowners, including the filing of resolutions.

The Roundtable announcement lists several potential topics for consideration regarding the shareholder proposal process; among them ownership thresholds, resubmission thresholds, representation of long term retail investors, the cost of proposals to companies, and the influence of proxy advisory firms.

The current ownership threshold of at least $2,000 worth of a company's shares allows a diversity of voices to be heard including smaller investors. The requirement of ownership for at least one year prior to filing a proposal ensures that investors cannot simply buy shares before the filing deadline and sponsor a resolution. Raising the ownership threshold threatens to exclude smaller investors, which is problematic and raises concerns about the equality of the system. Shareholders big and small can make and have made valuable contributions to the companies that they own.

The issue of resubmission thresholds is also raised as a topic for discussion. We believe the current thresholds provide a framework that has served the process well. Minimum votes of 3%, 6% and 10% in the first, second and third years, respectively, of filing a proposal have provided a reasonable amount of time for emerging issues to receive increasing support among investors, while ensuring that only those proposals that garner meaningful support move forward and can appear in subsequent years.

The argument for raising thresholds has been championed as a means of addressing so-called abuses in the system, including claims that shareholder resolutions are a burden on the markets. However, the evidence tells a different story. In fact, there are relatively few resolutions that are filed and come to a vote each year. Approximately 200 social and environmental resolutions came to a vote this year, hardly a burden on the markets and companies. The vast majority of companies never even see a shareholder resolution. It is also worth noting that often resolutions are withdrawn by their proponent after prompting a productive dialogue and improved understanding between shareholders and management, leading to significant policy changes that can transform businesses. ICCR member experience has shown that approximately one third of resolutions filed result in dialogue and agreements, with resolutions being withdrawn from the proxy.

Increasing thresholds could prevent important issues from being considered. There are many examples throughout the history of shareholder engagement of issues that initially received little support, but went on to be appreciated for the serious risks presented to companies that they produced. The issue of declassified boards is just one example – in 1987 proposals on this issue received under 10% support; in 2012 - 81%, and it is now considered best practice.

There are numerous additional examples, including:

Resolutions with oil and gas majors beginning in 1998 requesting reporting on the risks of climate change. In the early years, these resolutions often received below 5% of shareholder support. The 2017 proxy season saw a resolution requesting a business plan in alignment with the 2° C warming threshold established in the Paris Climate Agreement achieve a 67% vote at Occidental Petroleum, 62% at ExxonMobil, 50% at PNM Resources and 48% at Dominion Resources.

Resolutions highlighting human rights risks in corporate operations and global supply chains have brought human trafficking and forced labor to the forefront. As a result of proxy pressure, sector leaders such as Coca Cola, HP, Ford and Gap now have human rights policies and supplier codes of conduct that help them uncover and eradicate these violations from their supply chains - along with the legal, reputational and financial risks they represent.

Proposals like these and many others could be excluded in increasing re-submission thresholds, potentially inhibiting important contributions to corporate governance that have proven to be beneficial to the long term health and performance of companies.
The influence of proxy advisory firms was also raised as a potential topic for review. Critics have posited misperceptions about these firms; including that they have excessive influence. While institutional investors do look to proxy advisory firms to provide research and guidance to help inform their decisions, the ultimate decision remains in the hands of the investor. There is no obligation to follow the recommendations of the proxy advisors, and there are plenty of examples in which investors vote counter to the recommendations. The real motivation behind the special interests opposed to the proxy advisory firms is to undermine the in-depth analysis that they provide and encourage investors to simply vote in alignment with how corporate boards and management see fit, regardless of fiduciary duty or interest in long-term shareholder value.

Critics of the shareholder resolution process including major trade organizations like the Business Roundtable, the National Association of Manufacturers, and the U.S. Chamber of Commerce use over-the-top rhetoric to try and discredit resolution sponsors, arguing that their motives are "political" and that they have no interest in creating shareholder value. These industry critics have a clear political agenda of their own – to limit the ability of shareholders to engage with the companies that they own, and to cripple the proxy process that has been in place for over fifty years. The long-term investors who are members of ICCR are deeply concerned about the returns on and growth of the investments in their portfolios. Our members press companies on environmental, social, and governance risks precisely because they are concerned with the long-term health of the companies in which they are invested. Many of the companies that we engage with see the great value that this engagement brings, for example, by enabling companies to identify and address reputational and legal risks in advance, before they become liabilities for the company.

For further consideration, attached is a white paper drafted by Ceres, along with ICCR and The Forum for Sustainable and Responsible Investment (US SIF) entitled, "The Business Case for the Current SEC Shareholder Proposal Process." This paper provides an investor perspective on the value to both companies and investors of the shareholder proposal process as currently outlined under SEC Rule 14a-8.

In conclusion, we reiterate ICCR's support of the shareholder proposal process as it is currently practiced under Rule 14a-8 and believe altering it risks the exclusion of voices that can be vital to this critical accountability tool. The filing of resolutions is a fundamental tenet of shareholder democracy that should be protected.

We appreciate this opportunity to provide input and look forward to providing additional written feedback following the Roundtable. Please feel free to contact me with any questions.

Sincerely,

Josh Zinner
CEO
Interfaith Center on Corporate Responsibility
jzinner@iccr.org

**Ohio Public Employees Retirement System**

OPERS

December 10, 2019

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20515

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20515

*Re: December 10, 2019 hearing entitled, "Oversight of the Securities and Exchange Commission"*

Dear Chairman Crapo and Ranking Member Brown:

We are writing on behalf of the Ohio Public Employees Retirement System (OPERS) to share our experience as a client of a proxy advisory firm (PAF) and to provide an institutional investor's perspective regarding the Securities and Exchange Commission's (SEC or Commission) efforts to regulate these entities. We respectfully request that this letter be included in the hearing record.

OPERS is the largest public retirement system in Ohio with more than one million active, inactive, and retired members. This means that almost one out of every 11 Ohioans has some connection to our System. Because many of our members do not participate in Social Security, OPERS will be their only source of retirement income. We are trustees of their retirement contributions and are required to act in their best interest.

This duty extends to the prudent management of the investments we make and manage on their behalf. Currently, OPERS invests more than $100 billion in capital markets around the world, including holdings in approximately 9,300 public companies. Returns on these investments fund approximately two-thirds of our annual benefit payments. It follows then that OPERS is focused on maximizing value across its investment portfolio.

History has shown that positive shareholder engagement is an integral part of maximizing shareholder value. As such, we consider effective engagement to be a key component of our fiduciary duty to our members. In fact, we regularly interact with public companies in order to establish a dialogue with boards of directors and management. These discussions allow us to better understand the viewpoints of the companies in which we are invested and provide us with opportunities to offer our thoughts and concerns regarding the maximization of shareholder value.

However, with limited staff and resources, it is practically impossible to devote the necessary time and attention to the thousands of shareholder meetings and proxy votes that are held each year. Consequently, it was necessary for OPERS to hire a PAF in order to fulfill its governance obligations, and to do so in an informed, productive, and efficient manner.

Like most institutional investors, OPERS has developed its own corporate governance policies and proxy voting guidelines, which are integrated with our PAF's voting platform and dictate every vote cast on our behalf. In this way, OPERS maintains complete control over its proxy votes, even though in most cases they are functionally being cast by the PAF. Further, we perform monthly audits of our PAF to ensure compliance with our policies and guidelines.

Additionally, we depend heavily on the research reports we purchase from our PAF. They are critical to the internal analyses we perform before any vote is submitted. It is not hyperbole to say that without access to this timely and independent research, it would be virtually impossible to vote each of our proxies in an informed and effective manner.

We have communicated this information to the SEC on several occasions, including as a participant in the Commission's recent Roundtable on the Proxy Process. In each instance, our request has been respectful and consistent: that the SEC preserve our access to independent, timely, and cost-effective research and advice from our PAF.

In spite of these and similar pleas from other institutional investors, the Commission has chosen to release a proposed rule (*"Amendments to Exemptions From the Proxy Rules for Proxy Voting Advice,"* published in the Federal Register on December 4, 2019) that will, among other things, provide issuers with a lengthy period of time to review PAF advice and recommendations *before* they are provided to the clients that have paid for the information. And while there is no requirement that PAFs change their recommendations in response to feedback provided by an issuer, we are concerned that "proxy voting advice could be subject to SEC enforcement actions or even private actions under Rule 14a-9."[1] If that is the case, there is at least a threat that the Commission's proposal and preceding guidance "opens the door to SEC enforcement actions or potential claims by issuers who disagree with the client voting guidelines ..."[2]

Following the release of this proposal, we are faced with the possibility that we may no longer be able to rely on the timeliness, independence, or even the value of the information we purchase from our PAF. Frustratingly, the SEC has proposed these sweeping changes to the business relationships between PAFs and their clients based on a minimal amount of evidence, and instead has relied on speculation and anecdotes to draw and support its conclusions.

As we digest the Commission's proposal and contemplate our response, we are hopeful that, upon being presented with data and real-world experience regarding the value added by PAFs and the validity of the information they provide to their clients, the SEC will soften its approach. Our goal is not to simply and stubbornly resist the SEC's efforts, but to preserve our access to the resources we need to efficiently and effectively exercise our ownership rights as shareholders, including the right to raise objections regarding decisions that will negatively impact the value of our investments. We believe we can accomplish this goal and still improve upon the current

[1] Cydney S. Posner, Cooley LLP, "ISS sues the SEC—what will it mean for regulation of proxy advisory firms?" https://cooleypubco.com/2019/10/31/iss-sues-the-sec-what-will-it-mean-for-regulation-of-proxy-advisory-firms/#page=1, October 31, 2019

[2] Institutional Shareholder Services Inc., v. Securities and Exchange Commission and Walter Clayton III, Case 1:19-cv-03275, District Court, District of Columbia, October 31, 2019

regulatory structure governing PAFs. If it is willing, we are committed to working with the Commission to mutually benefit all parties to the proxy process.

As the Committee exercises its oversight of the SEC, we respectfully request that you inquire into the Commission's proposal on PAFs and the potential consequences such a proposal could have for public institutional investors who, like OPERS, are charged with safeguarding and growing the accumulated retirement contributions of millions of the men and women who serve us on a daily basis. We humbly ask that you encourage the Commission not to take actions that will increase our costs, compress the timelines we have for receiving and reviewing research reports, or diminish the independence of the research we receive from our PAF.

If you have questions regarding OPERS' comments, please do not hesitate to contact OPERS' Corporate Governance Officer, Patti Brammer, at 614.225.0942.

Sincerely,

Gordon Gatien
Director, External Relations

Patti Brammer
Corporate Governance Officer

Publish What You Pay
United States

ActionAid International USA
Amnesty International
American Jewish World Service
Bank Information Center
CARE USA
Catholic Relief Services
Columban Center for Advocacy and Outreach
CorpWatch
Crude Accountability
EarthRights International
EARTHWORKS
Environmental Defense Fund
EG Justice
Environmental Defense
Friends of the Earth
Gender Action
Global Financial Integrity
Global Rights
Global Witness
Government Accountability Project
Human Rights Watch
International Budget Project
International Labor Rights Forum
Justice in Nigeria Now
Micah Challenge USA
Natural Resource Governance Institute
Open Society Policy Center
Oxfam America
Pacific Environment
Presbyterian Church USA
Project on Government Oversight
Robert F. Kennedy Center for Human Rights
Sierra Club
Sustainable Energy & Economy Network
United Methodist General Board of Church and Society
United Steelworkers
United to End Genocide

December 11, 2019

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
534 Dirksen Senate Office Building
Washington, D.C. 20510

**Re: Full Committee Hearing, Oversight of the Securities and Exchange Commission**

Dear Chairman Crapo and Ranking Member Brown:

I am writing on behalf of the Publish What You Pay – United States (PWYP-US) coalition to thank you for convening today's hearing entitled, "Oversight of the Securities and Exchange Commission" and to share our position on the vital importance of the forthcoming natural resource extraction anti-corruption rule that will implement the requirements outlined in the Cardin-Lugar provision (or Section 1504) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[1]

The bipartisan Cardin-Lugar anti-corruption law directs the Securities and Exchange Commission (SEC) to implement regulations requiring oil, gas and mining companies listed on U.S. stock exchanges to publicly disclose the payments made to U.S. and foreign governments in exchange for the rights to extract oil, gas and minerals. The law is intended to shine a light on an industry that has all too often been plagued by corruption and mismanagement. Transparency of oil, gas and mining revenues enables citizens in resource-rich countries to hold their governments to account, deters corruption, benefits companies and investors, promotes the effectiveness of U.S. foreign aid, and is critical to U.S. energy security and national security interests.

To fulfill these goals, it is essential that the rule proposed by the SEC require fully public disclosure of payments by individual issuers at the project level.[2] In light of the significant shifts in the international arena over the past ten years, and given that full project-level transparency has become the industry norm around the world, only a rule with these essential components can achieve the intended goals of Congress in the passage of Section 1504.

PWYP-US regrets that a Congressional Review Act ("CRA") resolution of disapproval was enacted in February 2017 to delay final implementation of Section 1504. However, the SEC remains obligated to implement a rule that is consistent with the plain language and clear Congressional intent behind Section 1504, closely aligned with the international transparency standard already being implemented around the world, and supported by the robust public record developed over the past decade. Congress did not alter, nor purport to alter, the original statutory directive in Section 1504 or the SEC's obligation to adopt a regulation based on a rulemaking record compiled in accordance with the Administrative Procedures Act.

Congress intended Section 1504 disclosures to provide investors with detailed information needed to assess risk and make better investment decisions, to combat and deter corruption, and to empower citizens of resource-rich countries with the information they need to monitor revenue flows and hold their governments accountable for the responsible management of their natural resource wealth. In enacting Section 1504, Members of Congress were also clear that the establishment of an international transparency standard was one of the intended objectives of the statute,[3] and they have repeatedly reaffirmed that objective in comment letters to the SEC's rulemaking record.[4] A rule that failed to support the international transparency standard would run directly counter to Congressional intent.

The SEC cannot achieve these intended goals unless the new rule, at a minimum: 1) requires fully public, company-specific disclosure at the country and project level; 2) includes a sufficiently granular definition of "project" in line with the global standard that is already being implemented in other markets; and, 3) allows for no categorical exemptions.

Since Congress first enacted the law in 2010, and since the SEC's prior rulemakings, the transparency landscape has shifted significantly, with continued progress towards greater disclosure. The SEC's 2012 rule (Release No. 34–67717; File No. S7–42–10) catalyzed similar mandatory reporting requirements around the world. Today, disclosure rules in 30 countries across Europe and Canada, and the Extractive Industry Transparency Initiative ("EITI") Standard, which covers many additional countries, all require public disclosure of disaggregated, project-level payments on a company-by-company basis, without any categorical rule-based exemptions.

The 2019 updates to the EITI Standard now require disaggregated public reporting at the project-level in all 50 EITI member countries and require all EITI countries to publish oil, gas or mining contracts signed or amended after January 2021. These revisions to the EITI Standard were approved by the EITI Board, which notably includes U.S. companies such as ExxonMobil, Chevron, Freeport McMoran, and foreign issuers such as Shell, Total, Equinor, and Rio Tinto.

Because of this global progress, the International Monetary Fund (IMF) recognized project-level payment disclosure and the publication of contracts in its revised Fiscal Transparency Code as "*key transparency practices... now established as international norms.*"[5] These are the essential elements of the international standard that must be reflected in the SEC's new rule.

With implementation of the global transparency standard underway outside the United States, major oil, gas and mining companies – including a number that are cross-listed in the US – have now disclosed multiple years of project-level payment information under the rules in other markets. Over $800 billion in payments made to 152 countries have been disclosed by roughly 850 public, private and state-owned companies. This includes many of the world's largest diversified oil and gas companies including BP, Shell, Eni and Total, as well as US companies like ExxonMobil and Chevron, which are reporting over $24 billion and $12.5 billion respectively in payments by their subsidiaries covered by disclosure rules in other markets. Many major state-owned and partially state-owned oil companies are also covered by the disclosure rules, such as Russia's Gazprom and Rosneft, China's Sinopec and CNOOC, Norway's Equinor, and Brazil's Vale. Major mining companies such as BHP Billiton, Rio Tinto, Barrick, Glencore, Goldcorp and others are also reporting.

Although reporting in other markets began relatively recently, these disclosures are already providing investors with critical information to assess risk[6] as well as providing citizens with first-time data that they use to amplify their advocacy with their governments to ensure accountable natural resource management and combat and deter corruption. Already, there are citizens around the world using the data from these reports to inform and mobilize their communities in resource-rich areas to demand accountability of oil and mineral revenue management from their national and local governments. In Zimbabwe, government entities actually invited civil society to analyze the payments to government reports with government officials in a collaborative effort to tackle corruption.[7] Implementation of consistent rules in the US will ensure broad market coverage that amplifies the work already being done outside the United States and reinforces the benefits already taking root.

Experience with implementation over the last few years also proves that the costs of disclosure are substantially lower than the SEC previously predicted and none of the companies have reported any conflicts with foreign laws.[8] Any suggestion that U.S. companies would somehow face a competitive disadvantage from having to report project-level payments is no longer tenable, with so many of their competitors (including many state-owned companies) and their own subsidiaries already reporting this information without issue.

The foregoing shows the significant normative shifts that have occurred in recent years that must be taken into account by the SEC in a new rulemaking. We respectfully request that you reaffirm with Chair Clayton the clear Congressional mandate set forth in Dodd-Frank Section 1504, including the importance of supporting the international transparency standard, and urge him to release a proposed rule that fulfills this mandate by aligning with the unequivocal global standard for public project-by-project reporting of payments in the global oil, gas and mining industries.

Sincerely,

Kathleen Brophy

Kathleen Brophy
Director
Publish What You Pay – United States

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[1] Read the text of Section 1504 here: http://pwypus.wpengine.com/wp-content/uploads/2016/05/1504-Law-Text.pdf

[2] Here we are referring to the contract-based definition of "project" consistent with the Commission's June 2016 rule (Release No. 34-78167; File No. S7-25-15), and laws in the European Union, Canada and Norway.

[3] See: 156 CONG. REC. S3816 (daily ed. May 17, 2010) (Statement of Senator Lugar, one of the sponsors of Section 1504) ("Adoption of the Cardin-Lugar amendment would bring a major step in favor of increased transparency at home and abroad. More importantly, it would help empower citizens to hold their governments to account for the decisions made by their governments in the management of valuable oil, gas, and mineral resources and revenues. . . . The essential issue at stake is a citizen's right to hold its government to account."); id. at S3817-18 (May 17, 2010) (Statement of Senator Dodd) ("[C]ountries with huge revenue flows from energy development also frequently have some of the highest rates of poverty, corruption and violence. Where is all that money going? [Section 13(q)] is a first step toward addressing that issue by setting a new international standard for disclosure.").

[4] Comment submitted by Sen. Benjamin L. Cardin, et al. (5 Feb. 2016). Available at: https://www.sec.gov/comments/s7-25-15/s72515-19.pdf ("aligning the rule with the disclosures rules in the European Union (EU) and Canada, as well as the [EITI]" is "an important step in developing a global standard for the extractive industry"); Comment submitted by Sen. Cardin, et al. (1 May 2014). Available at: https://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/resourceextractionissuers-41.pdf; Rep Maxine Waters, et al. (11 June 2014). Available at: https://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/resourceextractionissuers-50.pdf. See also comment submitted by Former Senators Richard Lugar, Carl Levin, and Christopher Dodd (4 Feb. 2016). Available at: https://www.sec.gov/comments/s7-25-15/s72515-20.pdf.

[5] International Monetary Fund; Fiscal Transparency Initiative: Integration Of Natural Resource Management Issues FISCAL TRANSPARENCY INITIATIVE: INTEGRATION OF NATURAL RESOURCE MANAGEMENT ISSUES, at 7 (2019) (emphasis added). Available at: https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/01/29/pp122818fiscal-transparency-initiative-integration-of-natural-resource-management-issues. See also id. At 4 (noting "Fiscal transparency practices in the extractive sectors have made significant progress over the last decade," including "a transition towards reporting of resource revenues by both governments and resource companies, and in some countries, the publication of resource contracts and disclosure of the beneficial ownership of resource rights.")

[6] Comment submitted by Perrine Toledano, et al. (10 December 2019) Available at: https://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/cll6-6521646-200386.pdf

[7] Comment submitted by Miles Litvinoff. (25 November 2019). Available at: https://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/cll6-6470014-199342.pdf

[8] Department for Business, Energy and Industrial Strategy (BEIS), Reports on Payments to Governments Regulations: Final report, BEIS Research Paper, Jan. 2018, http://www.legislation.gov.uk/uksi/2014/3209/pdfs/uksiod_20143209_en_001.pdf; and BEIS, The Reports on Payments to Governments Regulations 2014, Post Implementation Review, PIR No. BEIS024(PIR)-18-BF, Feb. 2018, http://www.legislation.gov.uk/uksi/2014/3209/pdfs/uksiod_20143209_en.pdf

Trinity Health

Sen. Sherrod Brown
Senate Banking Committee
United States House of Representatives
503 Hart Senate Office Building
Washington, DC 20002

December 6, 2019

Re: SEC Proposed Regulatory Changes to Shareholder Proposal Process

Dear Sen. Brown,

On behalf of Mount Carmel Health System, I want to make you aware of our position on the recent regulatory changes proposed by the Securities and Exchange Commission (SEC) to 14a-8 rule which will undermine a critical mechanism for corporate accountability: the shareholder proposal process. We strongly disagree with the rules proposed by the SEC on November 5th, 2019, which will severely limit the rights of shareholders to engage with corporations using the shareholder resolution process over issues with a distinct impact on long-term value.

We are pleased the Senate Banking Committee has agreed to hold a hearing regarding these SEC changes on December 10, 2019 and would like to offer some perspective on our work in shareholder advocacy for your consideration.

The SEC has proposed the following changes:

- Increases in ownership thresholds to file, which will make it difficult for smaller investors to voice important concerns and raise issues of risk to the companies they own. The current ownership threshold of $2,000 ensures that a diversity of voices are heard, not just the biggest players. Small investors have contributed a multitude of now commonplace best practices.
- Increases in resubmission thresholds, which will result in the exclusion of important proposals that gain traction over time, and will ultimately stifle key reforms. Over the history of shareholder advocacy, resolutions that initially received low votes oftentimes gained significant support or led to productive engagement, as shareholders came to appreciate the serious risks they presented to companies.
- Changes regarding proxy advisory firms which impede the ability of institutional investors to get independent advice and information about how to vote on director elections, Say on Pay ballot items and shareholder proposals. This change would undermine the voice of investors and produce more management-friendly votes, unfairly stacking the deck against shareholders and towards corporate management.

**Background**

For decades, our Mount Carmel, as part of Trinity Health, one of the largest multi-institutional Catholic health care delivery systems in the nation, has used our shareholder voice to foster productive investor dialogue with corporate management and boards on key environmental, social, and governance issues. The current process works, and holds corporations accountable to all of its shareholders, even those with smaller interests. It has served as a cost effective way for corporations to better understand the concerns of long-term shareholders regarding the long-term

Trinity Health



value of the companies that they own.

The current 14a-8 rule has worked well for decades, and there is no need to revise it. Trade associations like the Business Roundtable, the U.S. Chamber of Commerce, and the National Association of Manufacturers have lobbied rigorously for the proposed changes by exaggerating the cost of the process to companies, and by misleadingly painting shareholders raising ESG issues as "activists" imposing a "social agenda" who are "uninterested in shareholder value." This misinformation feeds a political agenda by the trade associations to limit the ability of shareholders to engage with the companies that they own.

As a direct result of shareholder resolutions brought by responsible investors, longer-term emerging risks have been identified early and proactively managed to the financial benefit of hundreds of companies, the health of the environment, and the welfare of communities across the globe. Examples include:

- **Shareholder agreements on key governance issues with twenty opioid manufacturers, distributors and retail pharmacies** resulting in fundamental changes of their governance structures to strengthen oversight and better mitigate risks of addiction and overdose. Opioid manufacturers and distributors clearly have played a role in the opioid crisis, which has had such devastating consequences, and affects all of us. The full report by Investors for Opioid Accountability is available at these links http://uawtrust.org/IOA and https://www.iccr.org/our-issues/health/opioid-crisis.

- **Resolutions highlighting human rights risks in corporate operations and global supply chains** with companies in the apparel, electronics, automotive and agricultural sectors, bringing human trafficking and forced labor, into public view. As a result of proxy pressure, sector leaders such as Coca Cola, HP, Ford and Gap now have human rights policies and supplier codes of conduct that help them uncover and eradicate these violations from their supply chains - along with the legal, reputational and financial risks they represent.

Using a shareholder interest to drive changes in corporate behavior like those described above is exactly why Trinity Health has been engaged in shareholder advocacy for more than a decade. Trinity Health invests broadly in a variety of industries, including pharmaceuticals, to ensure we have a necessary return on investment and share ownership to claim a seat at the table to advance improvements in corporate behavior that benefit the bottom line and society at large.

**For the above reasons, we strongly urge you as a member of the Senate Banking Committee to work with the SEC to prevent these regulatory changes from being implemented.**

Sincerely,

Jason Koma
Regional Director
Government Affairs & Regional Development